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EMPLOYEE OWNERSHIP ON HOSTILE TAKEOVERS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE BENEFITS AND ABUSES OF EMPLOYEE STOCK OWNERSHIP PLAN [ESOP] FROM A HOSTILE TAKEOVER RAID

JUNE 26, 1987

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EMPLOYEE OWNERSHIP ON HOSTILE TAKEOVERS

FRIDAY, JUNE 26, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:05 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Riegle, Sasser, Sanford, Graham, Wirth, D'Amato, Hecht, and Bond.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

Today we hold a special hearing on the nexus of employee ownership on hostile takeovers. This hearing is part of our series of fact-finding sessions that will help us draft a fair and effective tender offer reform bill.

We have already held 4 such hearings and indeed we have introduced a bill. This hearing though may result in new provisions.

Employee ownership is a virtue that Congress has promoted for many years. The public policy advantages are self-evident. Economically, employee ownership translates into productivity. Companies with employee ownership are 1½ times as profitable as conventional firms, according to a survey made by the State of New York's Industrial Corporation Council.

The rate of job creation in employee-controlled firms is triple that of the average firm. Such benefits are widely recognized and now 18 States, along with Congress, have approved measures designed to encourage worker ownership. As a result, there are some 8,000 firms with significant worker ownership. Publicly held firms have 870 of the 1,000 largest form of employee stock ownership.

Before I introduce our first witness, I have statements of Senators Sasser, Sanford, and Graham to be submitted for the record.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, thank you for calling this important hearing today on the subject of employee ownership and corporate takeovers. There are significant indications that the rights of employee stock owners have been abused in the takeover process.

Indeed, in some cases trustee's of ESOP's have sold stock to corporate raiders in violation of the wishes of the employees and in contravention of their employment prospects. It is ludicrous that we can have a situation where employee stock owners lose their jobs because of a takeover, partly because their trustee tendered their shares to a raider.

I'm also concerned that two-tier and partial tender offers may disadvantage employee stock owners by giving the company new ownership without giving employee owners the opportunity to share in the sale of control premium. Indeed, in the typical takeover situation, where the company ends up leveraged to the hilt, the stock price will probably decline. So employees are at risk of losing their jobs and a deterioration in the value of their life savings.

We need to closely examine these questions. Perhaps there should be a mechanism incorporated into the securities laws which would permit employees to buy a company that is threatened with a takeover. At the very least, the law should permit a trustee to rely upon the direction of the participants in an ESOP as to whether their shares should be tendered to a corporate raider. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR TERRY SANFORD

Senator **Sanford**. Mr. Chairman, I would like to welcome our distinguished witnesses and thank them for taking the time to appear before us today. I am especially pleased that Bob Strickland could attend these hearings. I have a great deal of respect for Mr. Strickland, a North Carolina native who, armed with UNC Chapel Hill, Harvard Business School, and U.S. Naval Officer credentials has played a pivotal role in taking the Lowe's Corp. from six stores in 1957 to over 300 stores in 21 states last year. During his tenure at this company he has cultivated the respect of his 14,000 employees by avidly supporting employee ownership plans so that, in 1986, Lowe's employees owned in excess of 25 percent of Lowe's Corp. stock.

As I mentioned during yesterday's banking hearings we have seen an explosion of finance-driven takeovers by raiders in the past 3 years as the development of the junk bond, and its misapplication by investment bankers, has allowed the raiders to put companies into play without risk and thereby perpetuate the travesty of greenmail. Furthermore, when a raider attempts to step beyond the greenmail game and go for complete control of the company, another injustice is perpetrated, because while the efforts of these takeover technicians are often thwarted by management defense ploys, in many respects it becomes academic as to who wins the battle; society and the economy suffer in either event through divestitures and plant closings, through thousands of layoffs, and even on occasion through bankruptcies.

Now, we have before the 100th Congress a variety of well thought out bills designed to combat the problem of hostile takeovers. In this committee today we have the opportunity to examine another way of combating the corporate raider. The method I am referring to can give our single greatest resource, the American worker, the ability to vote as both a shareholder and a concerned employee.

Employee stock ownership plans, ESOP's, offer more than just retirement benefits. ESOP's offer the American worker a slice of American wealth that is at present disproportionately distributed. ESOP's allow workers to truly reap the fruits of their own labor. Employee Stock Ownership Plans offer us a way to return loyalty and pride to the American workplace. ESOP's create a partnership between workers, management, and majority owners; it is a partnership that facilitates increased capital availability and better communications between management and labor. Employee Stock Ownership Plans have even been used to save failing divisions and companies through employee buyouts. Though infrequently done, some 90 percent of firms subject to such buyouts since 1971 are still in business today.

Not only are ESOP's good for the workplace and for American financial markets as a whole, ESOPs offer significant advantages and incentives to both lenders and sponsoring firms. Tax incentives offered by past Congresses must be protected and continued by this Congress.

Of course, no plan is without its weaknesses. Recent cases like *Donavan* v. *Bierwirth* and *Norlin Corp.* v. *Chicago Pneumatic Tool Co.* have shown us that fiduciary concerns, trustee responsibility and participant right concerns do exist and must be monitored. Such problems are isolated though and do not negate the importance of the concept.

We must not let this opportunity pass us by. We must promote the future by encouraging long-term corporate planning, not short-swing profit taking. We must promote American workers and American wealth. We must protect American jobs and American competitiveness in the world marketplace. Only when we recapture the integrity of America's corporate structure will we be safe from the Indiana Jones type business practices we now see everyday.

I believe Mr. Chairman, that Employee Stock Ownership Plans may well be the catalyst we need to move us in that direction. I welcome our distinguished panel and thank them for their excellent testimony.

OPENING STATEMENT OF SENATOR BOB GRAHAM

Senator **Graham**. Mr. Chairman, let me thank you for holding this hearing today. I believe it is necessary to complete our hearing record on corporate takeovers. My concern is to find out if there is any characteristic of an employee-owned company facing a takeover that distinguishes it from a firm without employee-ownership facing a takeover. If so, what are those characteristics and what should the legislation look like to address these characteristics? During our hearings, we have not discussed the impact of a takeover attempt on employee-owned companies that are in either the bidder or target seat. Tax, ESOP, pension, ERISA, and SEC concerns are involved. Fiduciary responsibilities and voting rights are other impacted issues.

We have a very distinguished panel of witnesses today to help us consider these questions and to determine answers. I look forward to their testimony.

The CHAIRMAN. Most of the significant employee ownership is through Employee Stock Ownership Plans known as ESOP's. We are honored that our first witness is the father of ESOP, Senator Russell Long.

And largely through the initiative and inspiration of Russell Long, who served so long and so well in the U.S. Senate as chairman of the Finance Committee, the ESOP has had a great record and has an even more promising future.

Today we are going to consider the benefits and abuses of employee ownership during a hostile raid. Our shared goals is clear—to promote employee ownership. We will hear where employee ownership has improved a company's productivity from Robert Strickland of Lowes Companies in North Carolina. We will also hear that employee ownership does not necessarily mean that employees are respected during a change of control from F. Lee Bailey.

Employee ownership programs are often instituted during the heat of a takeover and to explain this are tacticians expert in the field, including Chicago attorney Jared Kaplan. But are these tactics helpful to employees or are they actually management tactics dressed in employee clothing? I expect Randy Barber of the Center for Economic Organizing, and William Palmer, a United Airlines pilot, will shed light on this question.

So, gentlemen, this is a live issue over the raids now outstanding on major corporations with significant employee ownership. I look forward to a fruitful session and our first witness is dad and mom and Doctor Long.

Senator LONG. I will try to summarize it, Mr. Chairman.

STATEMENT OF FORMER U.S. SENATOR RUSSELL B. LONG, SENIOR PARTNER IN THE LAW FIRM OF FINLEY, KUMBLE, WAGNER, HEINE, UNDERBERG, MANLEY, & CASEY, WASHINGTON, DC, ACCOMPANIED BY JEFF GATES

Senator LONG. With me here today is Jeff Gates. He's counsel in the same firm for which I work, Finley, Kumble, Wagner, and he was counsel to the Finance Committee for many years.

Let me just make it clear at the outset, Mr. Chairman and members, that the reason that most of our employee stock ownership legislation is in the tax area is because I served on the Senate Committee on Finance. If I had been on Armed Services, for example, I suppose all that legislation would be along the line of saying that if you wanted to have a Government contract that we would give you a better shot at it if you had an employee stock ownership plan so the workers were part of it.

ENCOURAGE EMPLOYEE STOCK OWNERSHIP

One morning I mentioned to my wife that I was thinking of various reasons why it would be good for workers to own stock in the company and she stopped me short. She said, "There's every reason that a worker would like to own stock in the company. Why don't you try to think of some reason why he would not want to own stock in the company?"

I have attached to my statement a memorandum summarizing many of the reasons why I believe we should encourage expanded capital ownership generally, and particularly employee stock ownership. Also attached is a summary of the ESOP tax incentives enacted to date.

During the years I served on the Finance Committee and on the Commerce Committee, in those two committees we enacted 19 separate pieces of legislation improving the prospect of employee ownership.

I am convinced that a great deal more can be done, especially in the committees that so far have not been very active in this area. My intention was to get the ball rolling in the hopes that others would continue to advance this worthwhile goal.

As you know, employee ownership has a lot to recommend it—for employees as well as for the public. Employee owners are more motivated and more dedicated. Work quality and workplace creativity increase. And we see greater productivity. Absenteeism, turnover and grievances decline.

We commonly see a better understanding by all employees of the company and what the goals are and an increased willingness to help achieve those goals. Employee ownership improves the quality of working life and provides a workplace environment from which employee involvement programs are more likely to emerge. In short, it results in a better managed and more efficient company.

Judging by results, one could conclude that the U.S. favors widespread home ownership. With the help of Government incentives, many enacted in this committee, home equity now totals $3.5 trillion. Approximately two-thirds of American families own equity in their homes.

Judging by results, one could conclude that the United States favors widespread public and private pensions. With the help of Government incentives, the total assets accumulated in public and private pension plans is rapidly approaching $2 trillion. In addition, Social Security laws assure that almost everyone living past age 62 will be assured a minimal level of retirement income and health care.

It is difficult to characterize Social Security entitlements as an asset because in the last analysis for the rank and file of Americans, his most important asset is a Federal assurance that his children will be taxed on his behalf.

Judging by the results, one could also conclude that the United States favors a high concentration of wealth as far as the means of producing goods and services are concerned. Now I don't think Congress necessarily wants it that way, but that's how it is. Judging by results, you would think that we in Government must have intended that.

According to a 1986 report of the U.S. General Accounting Office, except for the 22 percent of stock held in pension plans, 90 percent of all corporate stock is owned by just 10 percent of households and the majority of households own absolutely nothing. See the attached GAO report for that study.

Unfortunately, American corporate law has assisted the few in accumulating for their exclusive benefit most of the ownership of the means of producing goods and services. The typical takeover makes this bad situation worse.

The truth is that capitalism has done a very poor job of creating capitalists. Our concentrated pattern of capital ownership is a well-deserved embarrassment to us both here and in our international relations. ESOP financing provides a way to more broadly distribute this Nation's abundant wealth without redistributing the wealth of others.

This current takeover craze in the United States presents a great opportunity to advance employee ownership. Enormous amounts of income-producing capital are changing hands in the marketplace. To my way of thinking, that ownership is being transferred into far too few hands.

Employees' jobs are often endangered by the enormous debt that generally accompanies these transactions; yet employees seldom have an opportunity to gain a stake in the ownership being financed with that debt. Personally, I believe that employees are a corporation's natural shareholders.

If I had my way, any takeover being financed would include a large element of ESOP financing. Corporations incurring this enormous and expensive takeover debt should be encouraged to include as owners those whose efforts will be necessary to repay that debt.

The tax code encourages the use of ESOP's as a financing technique, either to finance or to ward off takeovers. For example, companies willing to finance their debt through an ESOP are able to take advantage of a tax deduction not only for interest but also for principal payments on the debt, up to 25 percent of payroll.

ESOP FINANCING

ESOP companies can claim a tax deduction for dividends paid on ESOP-held stock either when the dividends are used to repay an ESOP loan or when those dividends are paid out to employees.

In addition, banks lending to ESOP's have a more favorable interest rate than those who do not.

Unfortunately, we are not seeing ESOP financing widely used in these transactions and that's unfortunate. There are many reasons for this.

First, ESOP financing is not well understood. In addition, common greed plays a part. All too often, the principals in a takeover would rather hog up the entire deal for themselves than cut the employees in on it.

Unfortunately, there is also a large measure of regulatory uncertainty. I particularly have in mind the fact that the Department of Labor has, to a very large degree, frustrated our efforts to make employees shareholders in their companies. You would almost think that they are in the business to do that—to keep employees from being shareholders rather than to help them achieve that result. That's not how we in Congress intended it.

It is time that we had more positive incentives for employee stock ownership. For example, Safeway Stores was taken over through a leveraged buyout. There were 165,000 employees who could have been made shareholders. But none of them were. Then we see the takeover of Beatrice Foods. They had 100,000 employees, who I would like to have seen become shareholders in Beatrice, but none of them became shareholders. That's a total of 265,000 employees involved in those two takeovers. It would be easy, if Congress wanted to do it, to make it sufficiently attractive that those taking over the companies would have made shareholders and participants rather than be left out and be employees.

Frankly, I see very little social benefit in transferring enormous amounts of income-producing capital into so very few hands. On the other hand, I can see enormous benefits to be gained by transferring as much ownership as possible into the hands of those to whom a company must turn in insuring its long-range success and competitiveness—namely, the employees.

ESOP's can be used to encourage takeovers or they can be used to discourage takeovers. In my judgment, it's better for the takeover if employee ownership is broadened when that takes place.

On one crucial point involved here, I think the court decisions are not very helpful. That concerns the duty of the fiduciary. There's one recent court decision that concerns me and I think that should concern all of us. It indicates that in judging how to react to a tender offer that fiduciary should think about purely the financial advantage to those involved in terms of a higher price and what that may mean for future generations to ESOP participants.

That seems pretty ridiculous to me, as one who has run for office many times. To think that you have a fiduciary facing an offer where these employees will lose their jobs, buying their stock to put them out of work in the prospect that they will perhaps make $50 or $100 more per employee by losing their jobs. That's patently ridiculous and I would very strongly suggest that your legislation ought to indicate that that fiduciary has every right to vote the way those employees want him to vote.

It makes no sense whatever to say that he should be required to vote different than that, especially with management having made the move and come up with the capital to fund the proposal on the one hand, and employees, on the other hand, the intended beneficiaries, all agreeing that their stock should not be voted for a takeover because it's not good for the employees—to suggest that the fiduciary of the employees should vote the stock against their will is patently ridiculous and I would hope that this committee would change that as part of your legislation.

That logic is especially compelling when the document that created the employee stock ownership plan expressly indicated that this was to be used in a way that would help employees and advance what they want rather than what some stranger to the ESOP arrangement would like to see happen.

I also urge the committee to be sensitive to an employee ownership provision included in the Tax Reform Act of 1986. That provision allows a company to recover the excess assets in a defined benefit pension plan but only to the extent that the assets are transferred to an ESOP to buy employer securities for employees. That employee ownership incentive should be accommodated in your consideration of this bill.

I am convinced that companies that have not yet established an ESOP and companies that are not actively in the process of considering an ESOP are not well advised. In addition to the obvious financial, operational, and employee relations benefits of ESOP's, those considering a takeover, as well as those who consider themselves to be a potential takeover target, should realize that an ESOP established now can be a very effective instrument in either advancing or fending off a takeover.

LEGISLATIVE SUGGESTIONS

You asked for legislative suggestions and I want to make two in addition to those I've already made in the text.

First, I urge you to consider the idea of establishing within the banking system a preference for promoting employee ownership. There are several ways that this might be done.

The Government itself could establish an employee ownership bank. Ideally, its depositors could be drawn largely from companies with employee ownership and its commercial loan portfolio would consist of loans to companies willing to support employee ownership.

A new bank may be unnecessary if the existing banks could be encouraged to focus on this area, perhaps by granting preferred access to the Federal Reserve discounting system for notes representing ESOP loans.

Second, I note that absent from this draft is the requirement for an economic impact statement assessing the impact of takeovers. I understand the reason why that was deleted.

Let me suggest, however, an impact statement that would have no effect on efficient market operations. Consider requiring the filing of an ownership impact statement identifying the ownership beneficiaries of takeover transactions. In other words, who would benefit from the takeover? Let them identify that. This information is well known by the parties involved.

Where a takeover does not include a substantial element of employee ownership, you might consider requiring a statement explaining why. Congress approved incentives to include employees in these transactions. If they are not being included, we should find out why and see if we can do something about it.

This requirement could, in itself, do much to encourage employee ownership. If the American public better understood how few people benefit from these transactions, I believe they would press Congress for legislation ensuring that more people benefit.

FOREIGN OWNERSHIP OF U.S. ASSETS INCREASE

If they understood that foreign ownership of U.S. assets jumped by 26 percent last year, to $1.3 trillion, I think they would urge Congress to ensure that more Americans benefit from takeovers.

I couldn't help but compare. That to the fact that we have about $22 billion of stock in employee ownership plans. That's roughly about 2 percent of what foreigners own in American companies today. Our tax laws make it very easy and attractive for foreigners to own all that.

Once the public and affected employees begin to understand that there is an employee ownership alternative they will voice their preference for takeovers that include a substantial element of employee ownership.

One school of thought suggests that all takeovers are desirable, efficient, and good for the economy. I certainly disagree. Yet I believe that even those advocating that extreme position would agree that where takeovers include employee ownership they are far more desirable and make for a far more efficient economy and for a better country.

Within the jurisdiction of this committee, I feel certain there are many things that could be done. However, this is not my area of expertise and I will defer to your judgment, though I urge you to keep us informed as you proceed.

Enormous amounts of income-producing capital are changing hands due to these takeover transactions. Anything that this committee can do to ensure that those transactions operate to broaden the base of ownership in America, particularly among working Americans, would do a great deal to improve this country.

For the most part, these takeovers do not speak well for the image of the United States abroad. If the same transactions were structured to include a large component of employee ownership, they could show how this great country of ours can benefit the common working people of the country. At the same time, such a takeover structure could add a much needed boost to our international competitiveness.

I am very delighted to see this committee, Mr. Chairman and members, take this interest in employee ownership. With your support and encouragement, I have no doubt that employee ownership will grow and it will create a more equitable, a more productive, and a more competitive society.

Thank you very much.

[The complete prepared statement of Russell B. Long follows:]

Testimony before the U.S. Senate
Committee on Banking, Housing, and Urban Affairs

by

The Honorable Russell B. Long
Senior Partner in the Law Firm of
Finley, Kumble, Wagner, Heine, Underberg,
Manley, Myerson & Casey

June 26, 1987

Mr. Chairman and members of the Committee, accompanying me today is Jeff Gates, of counsel to our firm, who served as counsel to the Finance Committee and assisted me with employee ownership legislation.

Let me make one thing clear. The reason that so much of the employee ownership legislation is focused on tax incentives is because I served on a tax-writing committee. I am a great believer in employee ownership. If I had served on the Armed Services Committee, I expect you might now see defense contractors with employee ownership.

One morning I mentioned to my wife that I was thinking of various reasons why it would be good from a worker's point of view that the worker own stock in the company for which he works. She stopped me short saying: "There is every reason that a worker would like to own stock in the company. Why don't you try to think of some reason why he would not want to own stock in the company."

I have attached to my testimony a memorandum summarizing many of the reasons why I believe we should encourage expanded capital ownership generally, and particularly employee stock ownership. Also attached is a summary of the ESOP tax incentives enacted to date.

During my years on the Finance Committee, and during my years of serving on the Commerce Committee, we enacted 19 separate pieces of legislation improving the prospects for employee ownership.

I am convinced there is a great deal more that can be done to advance the idea of employee ownership. My intention was to get the ball rolling in the hope that others will continue to advance this worthwhile goal.

Employee stock ownership has much to recommend it -- not only for employees and for employers but also for the economy and for American society at large.

Employee-owners become more motivated and more dedicated. Work quality and workplace creativity increase. We see improvements in productivity and competitiveness. Absenteeism, turnover and grievances decline.

We commonly see a better understanding by all employees of the company's goals and what is needed to achieve those goals. Employee ownership also improves the quality of working life and provides a workplace environment from which employee involvement programs are more likely to emerge. In short, employee ownership results in better managed and more efficient companies.

I am also convinced that employee stock ownership plans (ESOPs) provide a more equitable way to finance the U.S. economy -- by providing an opportunity for working people to gain a stake in this great system of ours.

Judging by the results, one could conclude that the U.S. favors widespread home ownership. With the help of government incentives, home equity now totals approximately $3.5 trillion. Approximately two-thirds of American families own equity in their own homes.

Judging by the results, one could conclude that the U.S. favors widespread public and private pensions. With the help of government incentives, the total assets accumulated in public and private pension plans is rapidly approaching $2 trillion. In addition, our Social Security laws assure that almost everyone living past age 62 will be assured of a minimal level of retirement income and health care.

Of course, it is difficult to characterize Social Security entitlements as an asset when it is really a transfer payment, a promise that one generation will be taxed to support another. For the rank and file employee, his most important asset is a federal assurance that his children will be taxed on his behalf.

Judging by the results, one could also conclude that the U.S. favors a very high concentration of wealth as far as the means of producing goods and services are concerned. According to a 1986 Report by the U.S. General Accounting Office, except for the 22 percent of stock held in pension plans, ninety percent of all corporate stock is owned by just 10 percent of households. The majority of households own none. (See attached table from GAO Report.)

Unfortunately, American corporate law has assisted the few in accumulating for their exclusive benefit most of the ownership of the means of producing goods and services in the U.S. economy. The typical takeover makes this bad situation worse.

The truth is that capitalism has never done a very good job at creating capitalists. Our concentrated pattern of capital ownership is a well-deserved embarrassment to us in our international relations. ESOP financing provides a way to more broadly distribute this nation's abundant wealth without redistributing the wealth of anyone.

Employee Ownership and Takeovers

This current takeover craze in the United States presents a great opportunity to advance employee ownership. Enormous amounts of income-producing capital are changing hands in the marketplace. To my way of thinking, that ownership is being transferred into far too few hands.

Employees' jobs are often endangered by the enormous debt that generally accompanies these transactions; yet employees seldom have an opportunity to gain a stake in the ownership being financed with that debt. Personally, I believe employees are a corporation's natural shareholders.

If I had my way, any takeover being financed would include a large element of ESOP financing. Corporations incurring this enormous and expensive takeover debt should be encouraged to include as owners those whose efforts will be necessary to repay that debt.

The Tax Code encourages the use of ESOPs as a financing technique -- either to finance or to ward off takeovers. For example, companies willing to finance their debt through an ESOP are able to take a tax deduction for not only interest but also principal payments on that debt (up to 25% of payroll).

ESOP companies can also claim a tax deduction for dividends paid on ESOP-held stock, either when the dividends are used to repay an ESOP loan or when those dividends are paid out to employees.

In addition, banks lending to ESOPs are able to exclude from their income half the interest earned on ESOP loans. Thus, ESOP companies are able to borrow at less than the prime rate of interest.

Unfortunately, we are not seeing ESOP financing widely used in these transactions. That is unfortunate. There are many reasons for this. Let me mention just a few.

First, ESOP financing is not well understood. Much of the legislation is new, and the area is complex and rapidly evolving. Complexity alone can be a strong disincentive in transactions that move as fast as do many takeovers.

In addition, of course, common greed also plays a part. All too often, the principals in a takeover would rather hog up the entire deal for themselves than cut employees in on it.

Unfortunately there is also a large measure of regulatory uncertainty in this area. The Department of Labor has yet to issue valuation regulations that would be helpful in such transactions. In addition, their failure to issue guidelines, procedural or otherwise, concerning the proper equity allocation between parties in multi-investor transactions involving ESOPs has created an uncertainty that acts as a disincentive to include ESOPs in such transactions.

It is time we had more *positive* incentives for employee stock ownership in the takeover arena. For example, Safeway Stores was recently taken over through a leveraged buyout. Safeway employs 165,000 people. Had that leveraged buyout been structured with an ESOP, this nation would now have 165,000 new capitalists.

Instead, the transaction was structured to further enrich a small group of investment bankers and others, many of whom are already rich beyond the dreams of avarice. Likewise, the ownership of Beatrice Foods was recently transferred not into the hands of 100,000 Beatrice employees but instead into the hands of a very small, very select group of savvy investment bankers and other investors.

Frankly, I see very little social benefit in transferring enormous amounts of income-producing capital into so few hands. On the other hand, I can see enormous benefits to be gained from transferring as much ownership as possible into the hands of those to whom a company must ultimately turn in insuring its long-range success and competitiveness -- its employees.

ESOPs and Takeovers

ESOPs can be used either as a sword or as a shield. Knowledgable companies are awakening to the fact that employees can be friendly and patient shareholders. Thus, the better advised companies are beginning to establish ESOPs as a shield against takeovers. Similarly, as the ongoing negotiations at United Airlines indicate, ESOP financing can also be used as an effective sword in the takeover arena.

This defensive use of ESOPs can directly address one of the principal concerns raised by the legislation -- the difficulty facing management in managing for the long term and the resulting decline in America's competitive strength due to the obsession with the short term and the slighting of tomorrow in research, product development, market development and marketing, and in the quality of service.

Employee ownership can create a friendly and, most importantly, a "patient" reservoir of ownership -- one that can look to the long term and enable corporations to make the commitments to R&D, capital investment, etc. essential to maintaining competitiveness and to supporting American workers' wages and benefits.

Maintaining Employee Ownership

One issue that has proven troublesome to the use of ESOPs in the takeover arena is that of how employee ownership shares are treated in the case of a tender offer.

Current uncertainties in this area act as a *disincentive* to employee ownership. If the dictum in one recent case is followed, a company *with* employee ownership could be more vulnerable to a hostile takeover than a company without employee ownership. See Danaher Corp. v. Chicago Pneumatic Tool Co., 635 F. Supp. 246 (S.D.N.Y. 1986).

In that case, the judge suggested that, in responding to a tender offer, an ESOP trustee may not be permitted to rely on employees' directions and consider employees' concerns (such as preserving their jobs). Instead, the court suggested that the trustee may be required to take into account solely the *financial* interests of existing and future employees.

Ironically, this interpretation would mean that the vote on a tender offer through trust-type employee ownership (as in an ESOP) may be quite the opposite from the vote achieved through direct employee ownership. In fact, a trustee may even be required to vote *contrary* to the expressed interests of the employee-beneficiaries of an ESOP.

For example, a corporate raider may intend to totally dismember a company and throw employees out of work. Why shouldn't an ESOP be allowed to let employees vote on whether or not they think that is in their best interest?

I believe that an ESOP should be permitted to pass through to employees a decision whether or not to tender shares in an ESOP. After all, the plan was established to benefit *employees*. Shouldn't the plan be allowed to let employees determine whether or not to tender?

Similarly, if the plan provides that a fiduciary votes those shares, the fiduciary should be allowed to take nonfinancial considerations into effect. For example, a primary advantage to establishing an ESOP is to create an "ownership culture" in a company -- leading to a shared sense of values, workplace harmony, dedication and motivation.

Those concerns are real and substantial, and fiduciaries should be protected when those long-term employee stock ownership concerns are taken into consideration, particularly when that purpose is set forth in the ESOP documents.

It should also be clarified that an ESOP trustee may vote, exchange or tender unallocated shares in proportion to the way that participants direct that their allocated shares be voted, exchanged or tendered.

S.1323 addresses a related issue in its provision allowing pension fund fiduciaries to reject a tender offer without violating their fiduciary duties under ERISA. S.1324 goes a commendable step further in specifically allowing plan managers to consider long-term stock ownership options in discharging their fiduciary duties. A similar principal should apply to ESOP fiduciaries faced with a tender offer.

Another useful approach the Committee may wish to consider would provide employees a right of first refusal to utilize ESOP financing to acquire their employer when a tender offer is made. At the very least, they should be provided sufficient time to put together a competing bid.

This case is particularly compelling where employees already own a significant portion of the company or where they have recently made significant wage or other concessions.

As any investment banker will tell you, concessions improve cash flow and that improved cash flow can be borrowed against. Typically, a company can borrow five or more dollars for every dollar of concessions. That available leverage should operate to the benefit of the employees -- not to finance job-threatening takeovers for others.

Utilizing the tax benefits provided for ESOP financing, employees, whenever possible, should be provided an opportunity to produce a competitive bid for shareholder consideration.

The Committee need look no further than the recent acquisition of Eastern Air Lines, Inc. by Texas Air Corporation to find a persuasive example of why employee-owners should be allowed an opportunity to acquire a company, particularly a company in which employees already own a substantial stake.

I also urge the Committee to be sensitive to an employee ownership provision included in the Tax Reform Act of 1986. That provision allows a company to recover the excess assets in a defined benefit pension plan but only to the extent that

those assets are transferred to an ESOP to buy employer securities for employees. That employee ownership incentive should be accommodated in your consideration of this bill.

I am convinced that companies that have not yet established an ESOP, and companies that are not actively in the process of considering an ESOP, are not well advised. In addition to the obvious financial, operational, and employee relations benefits of ESOPs, those considering a takeover, as well as those who consider themselves to be a potential takeover target, should realize that an ESOP established now can be a very effective instrument in either advancing or fending off a takeover.

Employee Ownership Legislation

You asked for legislative suggestions to promote employee ownership. Let me offer two suggestions - in addition to those mentioned previously.

First, consider the idea of establishing within the banking system a preference for financing that promotes employee ownership. There are several ways this might be done.

The government could itself establish an employee ownership bank. Ideally its depositors could be drawn largely from companies with employee ownership and its commercial loan portfolio would consist of loans to companies willing to support employee ownership.

A new bank may be unnecessary if existing banks could be encouraged to focus on this area, perhaps by granting preferred access to the Federal Reserve discounting system for notes representing ESOP loans.

Second, I note that absent from this draft is the requirement for an economic impact statement assessing the impact of takeovers. I understand the concerns that led to its deletion.

Let me suggest, however, an impact statement that would have no effect on efficient market operations. Consider requiring the filing of an ownership impact statement identifying the ownership beneficiaries of takeover transactions. That information is well known by the parties involved.

Where a takeover does not include a substantial element of employee ownership, you might consider requiring a statement explaining why. Congress approved incentives to include employees in these transactions. If they are not being included, we should find out why and see if we can do something about it.

This requirement could, in itself, do much both to encourage employee ownership. If the American public better understood how few people benefit from these transactions, I believe they would press Congress for legislation ensuring that more people benefit.

If they understood that foreign ownership of U.S. assets jumped by 26% last year, to $1.3 trillion, I think that they would urge Congress to ensure that more Americans benefit from takeovers.

Also, once the public and affected employees begin to understand that there is an employee ownership alternative to takeovers, they will voice their preference for takeovers that include a substantial element of employee ownership.

One school of thought suggests that all takeovers are desirable, efficient and good for the economy. I disagree with that point of view. Yet I believe that even those advocating that extreme position would agree that where takeovers include employee ownership they are far more desirable, make for a far more efficient economy, and are much better for the economy.

Conclusion

Within the jurisdiction of this Committee, I feel certain there are many things that could be done. However, this is not my area of expertise and I will defer to your judgment on that matter, though I ask that you confer with us as you proceed.

I would urge you to keep one primary point in mind: enormous amounts of income-producing capital are changing hands due to these takeover transactions. Anything that this Committee can do to insure that those transactions operate to broaden the ownership base of America, particularly among working Americans, would do much to improve this country.

For the most part, these takeovers do not speak well for the image the U.S. projects abroad. Yet the same transactions, were they structured to include a large component of employee ownership, could show how this great system of ours can work to

the benefit of the common working people of this country. At the same time, such a takeover structure could add a much needed boost to our international competitiveness.

I am delighted to see this Committee's interest in employee ownership. With your support and encouragement, I have no doubt that employee ownership can continue to grow and that we can create a more equitable, a more productive, and a more competitive society.

Thank you very much.

0388B

M E M O R A N D U M

TO: U.S. Senate Committee on Banking, Housing and Urban Affairs

FROM: The Honorable Russell B. Long

DATE: June 26, 1987

SUBJECT: Why encourage expanded capital ownership?
Why encourage employee stock ownership plans (ESOPs)?

Reasons include:

- Promotes a wider sharing in the capital ownership benefits of capitalism.

  Note: According to a 1987 GAO Report, 89.9% of corporate stock (88% of bonds and 90.9% of business assets) are owned by just 10% of households. The top 1% of households own 58.4% of corporate stock. The top 0.5% own 45.6%. Figures include stock owned directly through mutual funds and exclude holdings of pension trusts (which hold 21.7% of corporate stock).

- Ensures that more taxpayers benefit from capital financing tax policies.

  Note: From 1975-1982, corporate savings from the two primary capital financing tax benefits (i.e., depreciation and the investment tax credit) totalled $1,208,000,000,000. Given today's capital ownership pattern, roughly half of those tax benefits were utilized to finance additional income-producing assets for just 1% of U.S. households.

- Offers the only feasible approach to fostering widespread sharing in the ownership benefits of free enterprise (i.e., utilizing corporate earnings to finance equity acquisitions for employees).

  Note: Practically all corporate funds are provided through three sources: (1) earnings and profits, (2) tax benefits and (3) debt -- none of which create any new owners. This "closed system" of finance explains why economy's capital base expands while its capital ownership base remains virtually unchanged.

- Offers an economic policy that can be embraced by both conservatives ("every man a capitalist") and liberals ("cutting the working man in on a piece of the action").

- Provides a non-redistributive way to expand capital ownership; not taking one person's capital to give it to another but instead encouraging our economic future to be financed so that more people have an ownership stake and encouraging transfers in ownership to be financed so as to create a wider base of capital-owning households.

- Provides a financing technique to broaden the ownership benefits attributable to mergers, acquisitions, divestitures and leveraged buyouts.

  Note: Such transactions totalled $35 billion in 1980, skyrocketing to $175 billion in 1985 -- consuming enormous amounts of tax benefits and utilizing a significant portion of the economy's credit capacity while transferring the ownership of large quantities of income-producing assets to a few managers, investment bankers and already-wealthy investors.

- Provides a forward-looking populist program - versus the "rearview mirror populism" represented, for example, by the estate tax or steeply regressive income taxes.

- Enhances motivation, dedication, quality, creativity and competitiveness.

- Improves productivity -- from both people and physical assets.

- Lessens absenteeism, turnover and grievances.

- Promotes a better understanding by all employees of an employer's goals and what is needed to achieve those goals.

- Improves the quality of working life (e.g., The 100 Best Companies to Work For in America found a close correlation between employee ownership and job satisfaction).

- Facilitates a new style of management (e.g., by encouraging the shift from a "control" management model toward a "commitment" model).
- Provides a workplace context from which employee involvement programs are more likely to emerge (e.g., quality circles, participative management, etc.).
- Saves time and costs by flattening the organizational pyramid; allows more time to be spent planning and less implementing.
- Blurs lines between manager and managed and helps insure that traditional labor/management issues (working conditions, pay and benefits) are resolved within a climate in which both parties share a commitment to maintaining their employer's long-term viability.
- Promotes a sense of shared values, the most powerful factor underlying the superior performance of the most excellent firms (as documented in In Search of Excellence).
- Promotes mutual trust and better communications -- as employees begin to be treated as co-owners.
- Fosters a workplace context better able to access the untapped potential reservoir of human energies, resources and commitment -- the root source of quality, creativity and productivity in any enterprise.
- Provides a way for employees to "harvest" the increased value created through superior performance (via equity sharing) without additional company cost (e.g., via profit-sharing).
- Provides a fairer distribution of rewards.
- Builds ownership into a company's natural shareholders -- its employees, rather than into absentee investors and speculators.
- Promotes widespread economic autonomy.

- Improves economic conditions of workers--insuring that they have an opportunity to participate in the economy both as labor workers and as "capital workers" (i.e., earning income not just from their labor during their years of employment but also from their capital during and after their employment).
- Enhances personal dignity ("working for ourselves").
- Empowers people.
- Updates government's role in promoting economic opportunity (not just jobs but also ownership).
- Offers a new economic model for the U.S. to advocate in its foreign relations (concentrated ownership continues to be capitalism's geopolitical Achilles heel).
- Provides an exportable model of capitalism (something this nation has yet to offer) -- demonstrating how capitalism can be structured to build capital for working people.
- Demonstrates how governments can implement free enterprise principles abroad.
- Promotes "patient" capital, allowing managers to manage for the long term -- rather than managing quarter-to-quarter in constant fear of a takeover.
- Provides a way to "anchor" domestic capital rather than have it flee overseas in search of lower labor costs.
- Provides a way to preserve a community's job-creating capital base (and its tax base) and to promote a company's loyalty to the community.
- Offers a more equitable way to respond to competitive pressures (e.g., employees working for the same or less pay in exchange for capital accumulation and dividend income).
- Provides a way to avert plant closings (e.g., via ESOP buyouts of viable companies).

- Recognizes that employees calculate "hurdle rates" differently than traditional absentee owners: for employees, maintaining their homes and their lifestyles, as well as their current jobs, are values that lead employee-owners to be more flexible -- both in terms of expected enterprise profitability and in terms of compensation.
- Enhances companies' flexibility and strength: the wider the choice of possible responses to a situation, the greater a company's chance of success (e.g., temporarily trading off cash compensation for capital accumulation).
- Enhances job security.
- Offers a new approach to job-saving "two tier" labor contracts (e.g., with senior employees taking more cash out of the company and newer employees accumulating more equity in the company).
- Can operate as the quid pro quo that overcomes the "downward stickiness" of labor costs --- the oft-lamented reality that frustrates the academic elegance of free market theorists.
- Promotes respect for private property.
- Fosters community cohesiveness.
- Enhances business continuity -- with companies sold to local employees rather than to absentee investors.
- Fosters widespread demand stimulation - with a capital source of income (dividends) supplementing labor income.
- Improves investment climate by creating a broader base of investors (the largest minority in this capitalist economy is comprised of those who own no significant amount of capital).
- Provides a process that enables people to gain an opportunity to participate - to give of themselves - and to feel that they are a part of something larger than themselves.

- Promotes economic and social justice.
- Increases social harmony -- by consciously creating more haves and fewer have-nots.
- Attacks the cause of poverty and dependence (i.e., a lack of "economic connectedness") rather than addressing only the effects (i.e., a lack of adequate income).
- Helps relieve the fiscal strain of transfer payments, tax incentives for retirement benefits and Social Security -- by promoting widespread economic self sufficiency via capital accumulation.
- Addresses the economic needs of the dominant age group.

  Note: In 1988, 61.5% of the voting-age population will be under 45 years of age. Are they more interested in retirement security (e.g., pension annuities and social security) or economic opportunity (i.e., capital accumulation)?
- Educates people about the advantages of a free enterprise private property system by the most effective means possible -- assisting them in gaining a stake in it.
- Recognizes that, in a market economy, outtake (i.e., income) is based on input and that, as technology moves through time, households need to be connected to their economy's increasingly dominant inputs (i.e., productive capital and the labor-saving, job-eliminating, income-producing technology embodied therein.)

  Note: The symptoms indicating the need for a more complete method of "economic connectedness" are rapidly becoming more obvious. For example, from 1979 to 1984, white adult males experienced a 53% loss in jobs paying twice the median income while experiencing a 97% increase in jobs paying half the median income. The middle class is shrinking and, for the first time in history, the U.S. has a rising generation assured of having a lower standard of living than that their parents.
- Promotes market-based, self-sustaining economic flows.

- By humanely financing the future, ensures that this nation's technology is designed to support a broad base of those whose culture gave rise to that technology.
- By enhancing economic security, makes it possible for more people to participate in cultural activities (leisure, music, religion, politics, education, child-rearing, etc.)
- Promotes environmental responsibility without increased government regulation by encouraging local versus absentee ownership or, as economists phrase it, "localizing control over the externalities".
- Recognizes (as a Federal system should) that the States (19 to date) are actively promoting employee ownership but that there is a limit to their capacity to effectively advance an idea so dependent on the national agenda.
- Establishes not a firm destination but a better defined and a more hopeful sense of economic direction.
- Provides a vision that serves as a challenge.
- Provides a national strategy that focuses less on the symbols of national unity and more on a strategy that can foster a true national unity - a unity that can command respect, nationally and internationally, over a long period of time.

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OVERVIEW OF ESOP INCENTIVES

1. Employer tax deduction. Up to 25% of participants' payroll may be deducted from the gross income of an employer to make principal payments on an ESOP loan used to acquire employer securities. Deductible contributions in excess of 25% are permitted to the extent the excess is used to pay interest expense on an ESOP loan.

2. Employee tax deferral. The annual addition that may be allocated to each participant's account in the plan cannot exceed the lesser of 25% of pay or $60,000. Stock acquired for employees' accounts is not taxed until distributed. Distributions are taxed at original cost utilizing 5-year averaging rates if received in a lump sum after age 59-1/2, on account of separation from service or due to death or disability.

3. Rollover of gain. If, after a sale of stock to an ESOP, at least 30% of the stock of a closely-held company is held by the plan, tax is deferred on any gain realized by selling shareholders to the extent that proceeds are "rolled over" (reinvested) in securities of other operating companies.

4. Lender interest exclusion. Commercial lenders and mutual funds may exclude from taxable income 50% of the interest earned on ESOP loans, thereby enabling lenders to offer lower interest rates for ESOP financing. The exclusion also applies to loans matched by contributions of stock to an ESOP provided the stock is allocated within one year.

5. Dividend deductions. Companies may claim a deduction for dividends paid on ESOP-held stock provided the dividends are either applied to repay an ESOP loan or paid out to employees on a current basis.

6. Estate tax advantages. An exclusion from an estate is permitted for up to 50% of the proceeds realized on an estate's sale of stock to an ESOP. The liability for payment of estate taxes may be assumed by an ESOP in return for a transfer from the estate of stock of an equal value, provided the ESOP company guarantees payment of the taxes and agrees to pay such taxes over a 14-year period with interest payments only for the first four years (4% interest on the first $1 million, prime for the balance).

7. Pension plan asset reversions. Employer reversions of amounts held in defined benefit pension plans are exempt from both employer income tax and the 10% reversion excise tax to the exent reversion amounts are transferred to an ESOP.

8. Exception to net operating loss limitations. The Tax Reform Act of 1986 imposes certain limitations on the use of a corporation's net operating loss carryforward deductions following a more-than-50% change in ownership. These limitations are inapplicable to a transaction which results in an ESOP owning at least 50% of the corporation.

9. Payroll-based tax credit ESOPS. Up to one-half of one percent of participants' payroll (through 1986) may be claimed as a tax credit provided the tax savings are used to fund an ESOP.

Table 4.1: Assets of All Households and of the Wealthiest Households, 1983

Type of asset	All households amount[a]	Percent of total for Wealthiest households		
		Top 0.5%	Top 1%	Top 10%
Trusts	$495.7	77.0%	81.6%	95.1%
Corporate stock[b]	1,006.0	45.6	58.4	89.8
Bonds	328.1	41.3	49.6	88.0
Business assets	2,274.6	39.0	51.6	90.9
Money market accounts	285.0	15.9	22.5	58.8
Real estate	5,355.0	14.9	19.3	49.2
Land contracts	111.0	13.9	15.2	50.4
IRAs and Keoghs	142.2	13.0	21.1	67.3
Checking accounts	115.9	9.7	17.2	46.3
Insurance cash surrender value	259.8	6.7	10.5	34.9
Certificates of deposit	383.1	4.8	10.7	49.9
Savings accounts	189.5	2.1	5.2	31.1
Automobiles	359.5	1.6	3.0	20.1
Miscellaneous	201.1	15.2	22.1	70.2
Gross assets	**11,486.4**	**24.8**	**31.6**	**63.6**
Net worth	**10,038.9**	**26.7**	**34.3**	**67.92**

[a] In billions of dollars.

[b] Including stock owned directly or through mutual funds, but excluding holdings of pension plan trusts.

Source: U.S. Congress, Joint Economic Committee, The Concentration of Wealth in the United States: Trends in the Distribution of Wealth among American Families (Washington: Joint Economic Committee, 1986), p. 24. The figures in the table are based on revised estimates provided to us by the Federal Reserve Board following publication of the Joint Economic Committee report.

ESOPs appear to provide a broader distribution of stock ownership than generally prevails (not accounting for pension funds or insurance company holdings). ESOPs are subject to the Internal Revenue Code coverage and nondiscrimination rules applicable to all qualified employee plans. Thus, broad participation in ownership of the sponsoring corporation's stock is a condition for corporate use of tax advantages related to ESOPs. Based on data from the IRS, the median rate of employee participation for all ESOPs is nearly 71 percent. This proportion does not vary much among the types of ESOPs, although the median for tax credit ESOPs, less than 63 percent, is somewhat lower than for other types. Assuming that the employees of firms with ESOPs include workers who differ widely in levels of wealth and income, then the high proportion of these workers participating in stock ownership through ESOPs suggests that these plans do broaden stock ownership within sponsoring firms.

The CHAIRMAN. Well, thank you, Senator Long. As I said to begin with, you are certainly the expert in this body on employee stock ownership plans, ESOP's.

Senator LONG. Only because Senators voted for it, Mr. Chairman. I want to thank you and all Members. Every member of the committee voted with us on this matter the last time we had it before the Senate.

The CHAIRMAN. Well, you've championed this for a long time. I think you make an awfully strong case for it. This is, as you say, capitalism at its best and most efficient, and you give some very impressive documentation of how very productive and efficient this has been.

But as far as takeovers are concerned, let me be devil's advocate and ask you this question. Would employee ownership in a takeover put jobs on a higher priority than efficiency as represented by profits and stock price, and therefore tend to diminish the effective productivity of a firm?

EMPLOYEE STOCK OWNERSHIP CREATE A PRODUCTIVE WORKFORCE

Senator LONG. Well, Mr. Chairman, you will have the chief executive officer of Lowes Companies before you today and I would suggest you just ask him, just as one good example, whether he thinks that they have a more efficient and productive work force in that company as a result of having a program where those people will have substantial stock ownership after working there over a long period of time. And he has a chart with him. I've seen it. He explained to me years ago how much just the average manager of a store would have if he stayed with that company for 30 years. You would be amazed to see how much that is. Those people see that they are going to be affluent citizens and they are going to have a lot, in addition to what we provide with Social Security and other retirement benefits. Those are just better workers. They are more harmonious. They have the interest of the company at heart. And the efficiency and cooperation you get in that respect can be compared to the kind of economic sabotage you get in some companies where they just feel like the employer is a bad guy.

In fact, I hate to say it, but that's how the average labor organizer goes about organizing companies. The first thing is to persuade the workers that these guys are bad fellows that you're working for, that they don't have the employees' interests at heart. When people think that way about the boss, you can understand how you don't get the productivity you should be getting from workers.

The CHAIRMAN. But you see what bothers me, I think that most people in this country want their jobs more than just about anything else, certainly more than any other economic element. They don't want a handout. Most people want to work and have the self-respect that goes with having a job. This is a very enduring and important attitude on the part of our people.

But in a hostile tender won't there be a tendency for a decision to be made on the side of jobs and not on the side of efficient, productive operation?

For instance, in the TWA case, one of the few cases where a takeover can be justified in terms of promoting efficiency, it eliminated a lot of jobs, just about wrecked the union, and threw a lot of people out of work. But it saved the corporation.

Now by going in an ESOP direction, are we going to prevent that kind of action?

Senator LONG. Well, let me just submit one simple aspect of this which I think covers most of the decisions that are involved in this legislation.

Let us assume that the fiduciary, which let us say is a bank, is holding this stock for the employees. Some of it is vested, some is not vested, but all of it was intended to be for their benefit. Let's assume 15 percent of the stock is held by the fiduciary and the employees.

Now let us assume that those employees know that their jobs are at stake. If this hostile takeover prevails, most of them are going to lose their jobs and they are going to move their headquarters somewhere else and merge with some other company and they're worried about the uncertainty. And one of the certainties is that a lot of them are going to be gone.

Now here these people are who have worked for this company, some for the better part of their working lifetime. They want that stock voted to say that when this is all over with they are still shareholders, but even more than that, they still have a job in the company.

And we have a recent court decision which has the effect of saying that if a raider offers 50 cents a share more—let's say you've got 100 shares of stock, so he's going to pay $50 more for your stock—that that person acting on your behalf, that fiduciary, has to sell your stock and put the worker out of his job.

The CHAIRMAN. We changed that in S. 1323. Our bill makes a change in that provision.

Senator LONG. And that's what I'm here to applaud. In other words, who has the right to be considered about how that employee's stock should be voted? Here it is. The company is doing something to benefit the employee and they think it's going to benefit the company because they are going to get better productivity and better cooperation. So all this stock is in suspense. It's gradually being vested in these employees.

Now, of course, they have a right to the stock that is vested in them, but that which is not vested is for their benefit. Now management puts the stock up. It's there for the benefit of the employees. If the employees and management agree that that stock ought to be voted against this takeover, against an unfriendly takeover, if the workers don't want it and the employer doesn't want it, why in the name of common sense should that fiduciary be required by a court to vote the stock against the employees?

It is ridiculous to claim that the fiduciary wants to benefit their grandchildren because the employees got $50 more when they lost their job. You wonder how in the world can somebody reach that conclusion. I'll only say that's one reason we shouldn't appoint those judges for a lifetime. Once in a while somebody ought to take a look at them.

How would you like to try to be re-elected when you've made a decision to put all your constituents out of work and you tell them that this is going to be good for your grandchildren? [Laughter.]

The CHAIRMAN. Senator Hecht.

Senator HECHT. My distinguished colleague from New York has asked that I yield a few moments of time because he's on a timeframe.

The CHAIRMAN. Go right ahead. Senator D'Amato.

Senator D'AMATO. Mr. Chairman, I'm going to have to go down to the Committee on Appropriations, as you well know, which is just meeting, and I just wanted to say it's great to see the old Russell back and he got wound up in there.

So I leaned over to our chairman and said, "That's the old Russell." And it certainly is a great, great, great pleasure to welcome our distinguished chairman and dean of the Finance Committee and a magnificent Senator that inspired so many of us from both sides of the aisle back to listen to him.

Mr. Chairman, I'm just going to simply ask that I be permitted to submit a statement for the record as if read in its entirety. I applaud the chairman for calling this hearing and certainly it's a great pleasure to have Russell here again.

The CHAIRMAN. Without objection.

STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. Mr. Chairman, I thank the witnesses for their provocative testimony this morning. Their statements have provided us with insights on the treatment of employee-owned companies confronted by corporate takeovers. For the first time, I believe the members of this committee have some understanding of the problems the courts have created for employee ownership of companies. At a time when the members of this committee have been seeking ways to promote employee ownership of their companies, Mr. Kaplan cites several recent cases where the courts have set up unnecessary roadblocks to the ability of employee-owned companies to oppose an unwanted acquisition.

Throughout these hearings I have tried to make it clear that the Federal securities laws were designed to protect shareholders. I do not want to pass legislation that is designed to protect corporate crybabies, boardroom fat cats or Wall Street manipulators, nor do I want to pass legislation that would impede legitimate takeover activity. The examples cited before us this morning highlight the need for greater shareholder protection in those instances where employees are substantial, if not majority, shareholders in their companies. I am also concerned about the practices that managements engage in that either disenfranchise shareholders or restrict their ability to participate in a tender offer. These practices are particularly egregious where they disenfranchise employee/shareholders. My only concern that the laws that would ensure the enhancement of employee/shareholder protections are outside those under the jurisdiction of this committee. Therefore, we should urge our colleagues on the Labor and Human Resources Committee to take note of our proceedings this morning.

Finally, I would like to make some observations about this week's hearings on the specific legislation examined this week. A little knowledge can be a dangerous thing. And that's all many of us have on the effects the legislative proposals before us today will have on contests for corporate control and the process of capital formation. The insight that tender offers can serve the important function of disciplining management in the modern corporation is undeniably a valuable one. In many instances, the tender offer has served that function admirably. On the other hand, we have witnessed certain abusive tactics attendant to corporate takeover activity and the use of these tactics must be severely restricted or eliminated. But the financial world is not so simple as Senators perceive it, economists assume it and law professors imagine it. While we have examined much anecdotal and some empirical evidence with regard to takeovers, we have yet to uncover the reasons for the growth of "merger mania" and ways to address abuses without impeding legitimate activity. Therefore, we should be wary of believing that simple legislative prescriptions will adequately address a complex phenomena.

Thank you, Mr. Chairman.

Senator LONG. I may not see you again for a long time and I hope that I may be permitted in this committee, notwithstanding the code of ethics, to tell you that I hope very much you're going to continue your fight to save the tax-exempt nature of both State and local bonds. Some of us are counting on you.

Senator D'AMATO. We are linked together inextricably.

The CHAIRMAN. Senator Hecht, you may reclaim your time.

Senator HECHT. Senator, I, too, feel that you had one of the most distinguished careers here and there's no one I admire more. But as I looked down, I suddenly am very unhappy because how fast people forget. After all your years in the U.S. Senate, just a few months ago you were serving as our colleague, and when you appear they put "Mr. Long". They did not even give you the courtesy of "Senator Long."

Senator LONG. Well, I've got identification around here that says it.

Senator HECHT. This is very thought provoking. I tried to follow you as much as I could. You were skipping back and forth in your testimony. I have some questions, but you were getting all wound up when your time was up. Would you continue? Because you were doing pretty good there and I enjoyed that. Would you continue on that train of thought that you had?

Senator LONG. About which now?

Senator HECHT. Just when you got interrupted about employee ownership and how the Federal judge should not be appointed for life and that type of thought.

Senator LONG. Well, since you brought that subject up—and I would urge that when you find time you read the whole statement—but let me just say something that's not in there I think that except by me expanding on it in answer to your question.

This committee doesn't have jurisdiction of what I'm talking about now. I suppose the Finance Committee or the Labor Committee could claim they have jurisdiction. But if you get very much involved and interested in something like this, as I was at one time, Senator Hecht, we fellows on the Finance Committee found ways to do things in areas that by rights we didn't have any jurisdiction to act on. Sometimes we'd say, look, this ought to be done but we don't have the jurisdiction, and others might object to us reporting out a bill that does this because it might trespass on someone's jurisdiction.

But when that bill is out there on the Senate floor, nobody can object to a Senator offering an amendment that does fall into somebody else's jurisdiction.

And you people ought to think about this fact a little bit, if you are concerned, as I am, about employee stock ownership. You should be concerned about the way that a fellow in the Labor Department is preventing employee stock ownership plans from ever going into effect. He got himself a job over there which is supposed to see to it that when an employee stock ownership plan goes in that it is a good deal for the employees.

Now I can understand a person every time one comes to his desk trying to make it a better deal than it is, and I can't quarrel with that. If he can use the leverage of that Federal power that's entrusted to him to make it a better deal for workers, fine.

But the way that character is using that power is to kill them all. It's sort of like the situation that I know that you know about—chances are your wife knows about such situations, where some lovely lady ought to be married and have a family and she would except that she set her sights too high. A lot of very good women never get married for that reason. They never find a perfect man.

So we've got ourselves a character over there in that Labor Department that can't approve anything. So the merger plans go through without any employee stock ownership because he's going to insist on the impossible whenever a plan for an acquisition includes an ESOP. So here's somebody trying to compete with an ESOP plan so the workers get stock in the company and a lot of it. Sometimes it's a chance to own it all. And he's killing all of those on the theory that it ought to be a better deal.

Now what happens? The companies go ahead and merge, a takeover happens, and the employees don't get any stock. You just ask the Kelso people. They prefer a plan for the employees to own stock in the company, but they are having to buy a company without an ESOP at all. Then after they own the company, they put the plan in because this character over there in the Labor Department won't let them buy it with the employees in it. They've got to buy it without the employees in it. And then after they own, then they put the employees in. Now that's a sad travesty to those of us who tried to see to it that they do have a plan and we created that job to see that the employees got a good deal. Instead, they get no deal at all. So he's denying what we intended them to have by taking the same type of attitude of that lady who never gets married because she wants to find the perfect man.

Now that's the best you can say about this man. I find myself suspecting that he's put there to see to it that no plan went through on behalf of some of these labor people. There are a lot of them who do understand that it is good, but there are a lot of them scared to death. They don't understand ESOP. They're afraid that they wouldn't know how to deal with it, afraid to get into some area with which they are not familiar.

Now that's an area where we need some help. That logically should come from the Labor Committee and I hope that they ask me to testify before them some day. I would like to tell them about that.

Senator HECHT. Thank you. Your words the last few minutes were right to the point because it's not just on this one issue but many other issues in our bureaucracy. People do not know how to handle a situation and therefore they say, no, I don't want to be a part of it. Thank you very much, Senator.

Senator RIEGLE. Thank you, Senator Hecht.

Senator Graham will question next and then shortly, because I must be on the floor for the trade bill, Senator Graham will chair this hearing for the rest of the morning.

Senator GRAHAM. Thank you, Senator Riegle.

Senator LONG. Senator Riegle, if I don't get a chance to say it, I'm sure happy to see you here. I hope you're enjoying your work on the Finance Committee. As you know, when I announced I was going to leave the Senate, I told you that I was keeping my promise to help you get on the committee.

Senator RIEGLE. Well, you did, and I'll tell you what I've learned, now that we've got a little revenue we have to find and I've got a lot of folks coming in who sort of feel like that gun is pointed at them, and your statement about don't tax you, don't tax me, tax the fellow behind the tree—I'm seeing a lot of those fellows behind the tree who are coming in to see me these days. I'm beginning to appreciate what being on the Finance Committee is all about. We'll talk about that in a minute.

Senator LONG. I think you will enjoy it. It's a great experience.

Senator RIEGLE. Well, I'm very honored to take the seat that you vacated and I've described to somebody else I feel a little bit like going to the pool table after Minnesota Fats has just cleaned it off. [Laughter.]

Senator GRAHAM. I assume, Mr. Chairman, that last statement was a political and not a physiological statement. [Laughter.]

Mr. Chairman, thank you very much for your participation. The question that I have been interested in and asking of other witnesses in the hearings that have preceded this is, are there special characteristics that relate to a corporation, either a corporation which is in an acquiring position such as United Airlines, or a corporation which is the object of acquisition such as Eastern Airlines, that distinguishes one because of a high proportion of employee ownership and, therefore, would justify some special provisions in our amendments to the Williams Act which relate to corporate takeovers and the SEC provisions relative to those?

FIDUCIARY RESPONSIBILITIES

You have suggested one, and that is the issue of the fiduciary responsibilities of those who represent the employee shareholders.

Are there any other specific either additions, deletions, or modifications to the bill that we have that you think would be appropriate as it relates to those corporations with a high proportion of employee ownership?

Senator LONG. Well, incorporated in this statement you will see that we suggest that where a takeover is involved that someone who wants to make an offer on behalf of the employees ought to be offered sufficient time to make an offer. Now that can have a big advantage to the employees.

Just take one example. Suppose I'm a raider and I'm planning to take this company over. Just as in warfare, the benefit of surprise is a big thing. So if you can come in here and you've got your backing and you make the offer and under the practices and the laws that exist there's every reason why those fiduciaries are going to have to sell that stock to you—I mean not only the employees' fiduciary but all those who represent the banks and the insurance companies and the mutual funds and all the rest—so that offeror will acquire that company.

But if when you come in to make that offer, if you fellows want to fix it this way, you can make it so that if someone on behalf of these employees wants to make an offer to buy at an even better price for the employees or for the same price, that they've got to give them sufficient time to put that offer together. It might not take long, but at least they've got to hold this thing open long enough for these fellows to get their proposal in.

Now if I was seeking to buy that company knowing that if this thing hangs fire for a week there may be somebody else with a better offer, I would be inclined to include the employees in my proposition, so that when we make this takeover, employees will continue at least to have what they have and maybe a little more stock. Now we're not asking that they give the stock away. What you're talking about is that the employees earn the stock, that over a period of time—it's best considered like green stamps when you go into a grocery store and every time you buy something you get a few green stamps. After a while it totals up and it's worth a lot of money. In some cases, it's worth hundreds of thousands of dollars to employees who work for a company for a lifetime.

Senator GRAHAM. One of the items that you mentioned in your statement was the protection of employee benefits such as pension plans. That's been a concern expressed, particularly in the context of acquiring groups then using the excess in an employee pension fund to help finance their acquisition.

Do you have any further comments as to what we ought to incorporate in this legislation as it relates to the protection of employee fringe benefits?

Senator LONG. Well, I'd be glad to give you a summary of what I have recommended here. Some are in the text and some are in the recommendations at the end.

LENDING CAPITAL TO EMPLOYEES

One thing that I did suggest is that you try to find a way to make the lending capital available to these employee takeovers because more often than not you have a situation where the employees want to make an offer but they can't borrow the money, and those employees are a lot better risks than appears on the surface. You can look at the Weirton Co. for example, where United States National Steel cooperated in helping them to buy that big plant. Otherwise, National Steel was going to move out and just leave them without their jobs. But now that's a more efficient operation and they have done more to improve their efficiency than anybody else in the steel business. Voluntarily, they took a big cut, about a 20 percent pay cut, and will take more if need be, but they took a 20 percent pay cut and they gave more efficiency and more productivity than before to save their jobs.

Now they are making a profit—incidentally, it's made a profit every quarter since the employees took it over. Now you would think that that type situation would deserve credit more than it would be where a private investor was coming in with some capital, a fair amount of capital on top, seeking to obtain loans to keep it going. And yet so far the lenders are not really sure. If they make the loan, they'll get a better interest rate because of the provisions we passed, but they would tend to be wary of making a loan just because they are not familiar with the success of employee ownership where you've got a good operation.

[The following was subsequently submitted for the record:]

[MEMORANDUM]

TO: Senate Banking Committee.
FROM: The Honorable Russell B. Long.
DATE: July 15, 1987.
RE: Hearings on Takeovers and Employee Ownership.

As promised, the following summarizes my primary recommendations concerning takeovers and employee ownership:

1. *Ownership Impact Statement.* Require the filing of an ownership impact statement identifying the ownership beneficiaries of takeover transactions. That information is well known to the parties involved and would have no effect on efficient market operations. Rationale:

a. Congress has approved numerous incentives to include employees in these transactions. If they are not being included, we should find out why and see if Congress can do something about it.

b. Takeover specialists should inform employees of the target company (whose efforts will be required to help repay takeover debt) why the principals in the takeover did not choose to take advantage of the available tax incentives to include employees in the transaction.

c. If the American public better understood how few people benefit from these transactions, they would press Congress for legislation ensuring that more people benefit.

d. Once the public and affected employees understand that there is an employee ownership alternative to takeovers, they will voice their preference for takeovers that include a substantial element of employee ownership.

2. *Right of First Refusal.* In companies with some significant degree of employee ownership (e.g., 10%) and in those where substantial concessions have been made, allow employees a "right of first refusal" when a tender offer is made. Rationale:

a. As any investment banker will tell you, wage concessions improve cash flow and that improved cash flow can be borrowed against. Typically, a company can borrow five or more dollars for every dollar of concessions. That available leverage should operate to create ownership benefits employees, not to finance job-threatening takeovers for others.

b. Congressional policy in encouraging employee stock ownership (for all the reasons set forth in the memo attached to my testimony: equity, productivity, competitiveness, quality of working life, dignity, etc.) dictates that employee stock ownership is qualitatively different from absentee ownership and should be granted preferred status.

3. Legislatively overrule the dictum in Danaker v. Chicago Pneumatic Tool Co., 635 F. Supp. 246 (S.D.N.Y.) that suggests an ESOP trustee, in responding to a tender offer, may not be permitted to rely on employees' directions and consider their concerns, such as preserving their jobs. Rationale:

a. If this dictum is followed, it could mean that the vote on a tender offer through trust-type employee stock ownership (as in an ESOP) could be quite the opposite of the vote achieved through direct employee stock ownership.

b. A trustee could even be required to vote contrary to the expressed interests of the employee-beneficiaries of an ESOP.

4. Clarify that if a plan provides that a fiduciary votes the shares held in trust, the fiduciary is allowed to take into account nonfinancial considerations. Rationale:

a. For example, a primary advantage of establishing on ESOP is to lay the foundation for creating an "ownership culture" in a company, leading to a shared sense of values, workplace harmony, dedication and motivation—a valid and Congressionally-sanctioned goal that trust fiduciaries should not only be allowed but encouraged to consider in determining whether to tender trust shares.

b. Fiduciaries should be protected when such long-term employee stock ownership purposes are taken into account, particularly when those purposes are set forth in the plan documents.

Senator **Graham**. Thank you. My time has expired.

Senator **Riegle**. Senator Bond.

Senator **Bond**. Thank you very much, Mr. Chairman.

OPENING STATEMENT OF SENATOR BOND

Senator **Bond**. Senator, it's a real pleasure to see you and have an opportunity to become acquainted with you. I have long admired your work and particularly your strong advocacy of employee stock ownership.

I happen to believe that that is one of the most significant things that we can encourage in the United States. I think we have seen in the United Kingdom that increased broader-based ownership is extremely important for the economic health of that country.

Over the last 2 years before I had an opportunity to join the Senate, I had a responsibility as a partner in a law firm and we served as counsel for the TWA Employees Committee which attempted to buy the airline back in 1985, and we found that obtaining the financing was absolutely the one stumbling block.

We had many discussions. The Employees Committee themselves pursued leads, some of them obviously people with schemes in mind to take advantage of the employees. We made trips abroad to track down supposed great pots of wealth. So far, we have never found the end of the rainbow and we never did find the pot of gold.

I was therefore quite interested in your comments on page 7 of your testimony about how we could assist in the financing and you referred briefly to the fact that there could be preference for financing that promotes employee ownership or the Government itself could establish an employee ownership bank. Both of these seem to be rather drastic modifications to our existing financial systems or regulatory system, but I would be interested if you could explain how you think that might work.

Senator **Long**. Well, first, let me say this, Senator Bond. It might not be necessary to have an employee stock ownership bank if you could make it attractive enough for the banks to make the loan.

Now if I were you working on that, I would—after all, this committee has a lot of expertise in the banking area and your staff has a lot of expertise, so I would first explore what you might be able to do to make it sufficiently attractive to the banks that they would make that loan.

Now I was here back in the days when we had the old Reconstruction Finance Corporation and also back when the Small Business Administration could make you a loan, and one big advantage of that was, even if they didn't make the loan, the banks would know that if they didn't make the loan somebody else would. That has some leverage effect in making them do it.

I'll tell you what I think about this. If you have a company where those employees want their jobs, they don't want to lose their jobs, and they would make a big sacrifice to keep them, and they will take a 20 percent pay cut if need be in order to hold on to their jobs.

Now the rule of thumb that I've seen is that for every dollar in pay cut those employees are willing to take in order to save their jobs, that's worth $5 on a loan. So assume that those guys are going to take a pay cut of 20 percent and assume that works out to $10 million on an annual basis and you ought to be able to borrow $50 million just on the basis of that pay cut. And those people have been known to voluntarily come in and offer to take that pay cut.

HIRING MANAGEMENT

Point No. 2, people making a loan want to know if this thing is going to be well managed because obviously if employees have the motivation and the operation is well managed it should make a good profit and be able to pay off the loan. Now I believe you can prove, if need be, that employees, properly advised, can hire management every bit as well as management can hire employees when management is properly advised. Now who is going to hire the management? Well, generally speaking, where you have the lender coming up with the money to make this takeover possible, as long as it's his money out there, he wants to be in a position to pass judgment—or even to hire that management, so he says, "Who is this going to be?"

Now in the Weirton situation, the workers would possibly have hired a popular plant manager who knew how to make steel and he might have taken over that steel company and gone ahead and done the best he could and they might have succeeded. But they had a much better chance of success when Lazard Freres, who was adviser on this matter, said,

> Wait a minute, if you're going to take this company over, you're going to have to expand your lines of production, you're going to have to come up with new products, you're going to have to modernize, you're going to have to think about world markets and international competition. You need a guy who has a far better education than that plant manager. You need a man who really has better credentials to deal with the investment community on Wall Street and that type of thing. You need a guy who has a better education and more experience in a broader area.

So they brought themselves in a fellow who has been a terrific success. He's done a great job for them. I think they found him at Ford Motor Co. I don't know the man personally, but all the results speak extremely well for this fellow.

You see, if you have good advice, you bring in somebody who's very good, and you've got the experienced employees who know what they're doing. They are dedicated and will make a sacrifice to save their jobs. There is every reason on Earth why that operation should succeed.

Senator **Bond**. Thank you, Senator. I see my time has expired, but I would say that your comments generally reflect the situation as we found it. All of the aspects are things that we saw in practice, with one exception; that even though people saw the value of proposed employee givebacks, they needed some equity up there and the inability to get that layer of equity was the thing that made it impossible.

Senator LONG. If I had been out there with you I think I might have shown you how you could lean on a few of those banks to help you get that loan.

Senator BOND. Well, sir, I'm sure that you will be able to do that job well for others and I wish you the best of luck.

Thank you, Mr. Chairman.

Senator RIEGLE. Thank you. Senator Sanford.

Senator SANFORD. Thank you. I'm certainly delighted to have an opportunity to have the benefit of your advice and thinking on this legislation.

I'd like to focus on one point of it because in drawing an additional bill, though I'm a sponsor of S. 1323, instead of putting in some amendments I put in another bill that pretty well parallels the first but went more into the financing, because it seems to me that in hostile takeovers the financing has been the most detrimental part of it, that substituted debt for equity. And while from an accountant's point of view that might be beneficial because debt is tax deductible, nonetheless, they overlook the fact that the taxpayers are paying for hostile takeovers.

Now what I wanted to do was to limit the amount of the assets of the target company that could be financed by junk bonds or by any kind of lending so that if you wanted to take over a company with a hostile approach you had to pay for it. You couldn't just run in there and steal it and then put up the assets with junk bonds to pay for it. That's what the pattern has been.

So my first approach was to say no more than 25 percent can be financed that way.

What I have been searching for and would like to have your advice as we go along, how do we say but you can finance all of it if you finance it into an ESOP; you can use all the assets or any amount of assets necessary if you come back with an ESOP as the final financial structure of the corporation? It would seem to me that would greatly encourage the use of ESOP's in the takeovers if we denied the junk bonds.

MANAGEMENT-GENERATED LEVERAGE BUYOUT

Now Burlington Industries has just gone through this. They withstood a Canadian effort to make this a Canadian company. It's our largest American textile company. But they lie now in financial wreckage as a result of that because they had to go to Morgan Stanley and do a leveraged buyout. And I inquired as they were beseeching us to help why they didn't move to an ESOP. That's the other way. Either the person taking it over or as a defense that instead of a leveraged buyout, and then just to add one other step, I see the next great fad coming on after hostile takeovers is to be the management-generated leveraged buyout. Wall Street is hawking that all over town now—come let us show you how to leverage your company and you own it, no matter what the size, which again I think is a detrimental trend because that again puts heavy debt. That ought to have the incentive in there for ESOP's.

So it seems to me ESOP is the greatest capitalistic invention of the last 50 years. It is capitalistic. So I want to see it promoted in ways beyond leveraged buyouts and hostile takeovers, but I especially would like to have you thinking of how we can make it so attractive that when you get into leveraged buyout or get into hostile takeover you almost have no alternative but to move to ESOP.

Senator LONG. Well, I strongly favor that. I am completely in agreement with you on your objective.

Now I think you're going to find after you go through the same hearing I've been through on junk bonds that that approach really is not going to be very productive. I say that because when we held a hearing in the Senate Finance Committee a year or two ago on these junk bonds, those people who issue those junk bonds made a fantastic presentation. I must say that as a fellow who sat through the hearing and had no knowledge of what this was all about at the beginning, they just carried the day. Judging the debate as a former college debater I would say that they won on all points. They made by far the better case.

So if you have the same argument here and the same hearing with the same witnesses on both sides, but I would predict that if you sit there and hear the witnesses testify for both sides and there will be brilliant people on both sides, but the people who are issuing those junk bonds are going to win the argument on that point because I went through it and they won it before the Finance Committee.

I think that you're going to find it useful to take another approach. I have no doubt that the power is there and you can come up with the tools that would achieve what you want. For example, if you wanted to say that where a takeover is involved, if somebody wants to make an offer on behalf of those employees and he represents a substantial number of them—but if the employees favor trying to buy this company themselves or trying to be a part of it, you could say that the company must give the employees representative time to put together an offer.

Then, if you made it sufficiently attractive so they could find the money to finance it—and meanwhile while you're at it, you'd better find some way to keep this character over there in the Labor Department from killing you.

Senator SANFORD. Why is it in the Labor Department? Why did that fellow get in charge of this?

Senator LONG. Well, that's a long story, but it has to do with the ERISA legislation where the late Jack Javits and others managed to put a provision in the ERISA law that they passed theoretically to protect—and I assume that they were in good faith wanting to protect the employees, saying that somebody in Labor would look at this thing to see if it's a good deal for labor, and that has just killed it time and again. Anytime an ESOP proposal finds itself in the hands of that character over there, forget about it, that's the end of it.

So you've got to see to it that that doesn't happen to you. You ought to check it out while you're at it, but assuming that you don't bypass him, this character will kill your ESOP plan. I would suggest that you invite Mr. Brock in to talk to him about that matter when you're acting, because there's no point in you working all that hard to try to pass something only to find this guy or some other bureaucrat is going to kill it all for you.

But once you've got it to where they have to consider the offer, once you get it to where it can be financed, and you have it within your power in drafting this legislation saying, all things being equal, they would take the offer that lets the employees be shareholders, then you have it won.

All these cases about what the fiduciary ought to do, you have it within your power to say right here in your committee what that fiduciary ought to do. That doesn't require a genius to figure out. Just ask the employees which way they would rather go and vote it the way they would like to have it.

Senator SANFORD. Thank you very much.

Senator LONG. Thank you so much.

Senator RIEGLE. It's such a delight to have you back here. It makes us remember very strongly how much we miss having you here and I hope that one of these days soon you will find your way back to the Members' dining room and come on in and we'll have a lot of good laughs and discussion together.

I want to say how much I appreciate the leadership that you have given on this issue and that you give today by preparing this testimony and coming in and focusing this issue. I think you open up that whole side of the debate in a way that has not yet really been seen and your leadership over the years on behalf of employee ownership I think has been one of the important contributions that we've seen here in the Congress, and I congratulate you for that and I thank you for it and I know employee owners across this country feel that way themselves because it does make a difference. The viewpoints changes.

I remember years ago I used to work at Sears Roebuck in the men's department and we had a commission system at that time. Now this is a different point but it's the same principle. And I know in terms of my efforts to sell socks or whatever it was, I worked a little harder because there was that commission, and even though it was small, it was an important incentive device. I think the same principle applies very importantly in a corporation or a company and that is, if you want a piece of that company and you've got the chance to participate in the benefits of ownership, growth of the company, the profitability of the company, to increase your stake over time, I think it does make a difference how you feel. I think it makes a difference in terms of how you think. I think it creates the opportunity to start to think from the point of view of what's involved in making a company successful and I mean from the point of view of even reading and beginning to understand what annual statements contain within them in terms of income statements and balance sheets and the challenges that face companies.

I would go even further I think and say, I think a person's job today and probably pretty much through the history of this country has been really the centerpiece of a person's experience because you love your family but you can't do much to provide for your family if you don't have a job and if you're not in the position to generate income and bring your skills to bear in that way.

So I think having a setting in which you maximize that is really the great challenge. That's the key to the whole thing. So I think your leadership in that area has really been important over the years and it's very important to us today and I'm going to see if I can't help carry that ball ahead.

Now I want to ask you one other question in an entirely different area because we've sort of been covering the waterfront here on ESOP's. But you were truly an expert witness on finding revenue and we are now under a mandate to find $19.5 billion worth of revenue under the budget that we have just passed.

Without trying to put you on the spot——

Senator SANFORD. That's why he decided not to run again. [Laughter.]

Senator RIEGLE. Well, in any event, you as much as anybody is the living, breathing expert on that question, and I'm just wondering as you think about it now, you know this puzzle inside and out, and we now put ourselves under that injunction to find that money, I'm just wondering in your own mind, as you look at the mix of revenue options, where you think how we ought to approach that issue.

Senator LONG. Well, Senator Riegle, you have heard me quote my Uncle Earl on occasion saying that a politician should never lie, not unless it is absolutely necessary. [Laughter.]

I think you fellows up here ought to keep the faith. I think when you tell somebody something you shouldn't retreat from it. If worst comes to worst, you can say I'm sorry, but go tell them I lied. It didn't work out that way. But if you can keep the faith, you ought to do what the people were told.

Generally speaking, people thought that we fellows on the Finance Committee had made a commitment that when they paid more taxes by giving up deductions that they were going to have a lower rate and they were led to believe the rate would be even lower than the 27 percent that we wound up with.

I think that ought to be permitted to go into effect and I differ with Speaker Wright in that regard. In my judgment, frankly, I think that his idea of postponing the vote count not only is it a bad idea, I think it's lousy politics to tell people that when they give up all these deductions and many of them are paying a big tax increase on balance, that they are going to have a lower rate, and then not keep the faith. I think that they ought to be permitted to have the rate that they were promised.

If you're going to do that, then you don't have much more potential about reaching out here on these so-called loopholes. About everything we could grab hold of we did in conference.

You are pretty well compelled to raise it in terms of taxes that are going to impact on consumption and therefore that leaves you with excise taxes—at some point, you might consider something broader than that, some sort of a supplement that would have the same effect as a sales tax or a value added tax. If you do it, you ought to do what Lester Thurow advocates. If you're going to have a broad-based consumption type tax, you ought to have a negative income tax feature of it that would give back to low income people what they are paying in that respect so that they would not be adversely affected. Everybody in the middle and upper brackets should pay something and really if what you're talking about is $18 billion, that's a lot of money, but if you level it across the economy and it's shared relatively evenly among the people, that's not a big tax—not if you say it fast. [Laughter.]

In terms of a value added tax, that would be one half of 1 percent, or in terms of a Social Security payroll tax it would be one half of 1 percent. And assuming that you protect the low income people from the burden of it, I would think that you really don't have a lot of money to raise in those terms if you're willing to think in terms of excise taxation.

Now I was on the committee, and I suspect that you were in the House at the time—we repealed practically all of our excise taxes. We used to have a tax on automobiles and all kinds of things out there, and I'm not advocating the automobile tax.

Senator RIEGLE. I'm glad to hear that.

Senator LONG. But let me just say, we had a tax on pens and pencils and all kinds of things that I think we called a luxury tax. It got pretty ridiculous. I recall a good point someone made because we classified baby oil as a luxury tax and some mother didn't agree with that at all. But it's easy enough to raise revenues if you're willing to think in terms of some tax where everybody pays a little something every time he buys something, or otherwise you ought to think about excise taxes. Every penny you raise on gasoline is $900 million to the Treasury, so that 5 cents would raise you $5 billion right there—$4.5 billion.

Senator RIEGLE. Well, I appreciate your being willing to step across that line in that other subject area.

Senator LONG. But I'm not running for office you know, Senator, obviously. It is easy to recommend when you do not have to take the heat.

The CHAIRMAN. Thank you, Senator Riegle.

Senator Long, you have been marvelous. You're a great Senator. You came to the Senate when you were 29 years old.

Senator LONG. I was 30 when I took my oath.

The CHAIRMAN. Now you look about 35. You've done a fine job. Thank you very much.

Senator HECHT. Mr. Chairman, may I just make one point?

The CHAIRMAN. Go ahead.

Senator HECHT. I'm sorry you were not here to hear our distinguished former colleague mention how he felt about junk bonds. I'm very sorry you were not here.

The CHAIRMAN. I like junk bonds, too.

Senator HECHT. I don't want to take the time today, but I hope you will tell him more about your thoughts.

The CHAIRMAN. I have nothing against junk bonds. Most firms issue what is called junk bonds. But I object to having the full faith and credit of the U.S. Government behind an S&L or a bank that is up to its neck in junk bonds or high yield bonds. They have to diversify, that's all.

Senator LONG. All I said about junk bonds is that when the proposal was made in the Senate Finance Committee that we should fix it so that you couldn't issue junk bonds to finance a takeover, that those who represented so-called junk bonds—Drexel and those people—made the better argument. I heard both sides presented and as one who came there neutral, I'd say that the junk bonds people won the day and I predict that if you have them before your committee the debate will probably go the same way.

The CHAIRMAN. Well, of course, this is a body that is expert on junk. [Laughter.]

Thank you very much.

Our next witnesses are Mr. Lee Bailey, lead trial counsel for the Eastern Airlines Coalition, and Robert Strickland, chairman of the Lowe's Companies of Winston-Salem, NC. Gentlemen, we are delighted to have you and I'm going to ask Mr. Bailey to lead off.

Mr. Bailey, you're a very distinguished lawyer and we sit in awe of you. Go ahead and awe us.

STATEMENT OF F. LEE BAILEY, JR., LEAD TRIAL COUNSEL, EASTERN AIRLINES COALITION

Mr. BAILEY. Thank you very much.

Mr. Chairman, members of the committee, I will not repeat the general proposals contained in my written statement because I would like to hone in on something that I think may assist the committee.

You are hearing today from witnesses who are very anxious to talk to you about the benefits of ESOP's and how they can help accomplish a number of desirable objectives. Indeed, I think they may be the ultimate answer to the socialist concept because when we have a capitalist competitive structure churning out money and the people who are doing the work owning a large portion of the machinery, that may be an ideal balance.

The people who do not want to testify before this committee are the ones who are engaged in defeating ESOP's, and I think in order to fashion remedial legislation which will address the problems that we have in trying to accomplish employee ownership you ought to talk to those people. The whole conundrum of defensive measures, poison pills, and so forth, is often viewed as a means for a few individuals at the head of a corporation to entrench themselves and put everybody else's rights second.

I have a heavy involvement in the Eastern Airlines effort and a similar involvement, although we came much earlier, in the United Airlines effort, and I would like to compare the two and give you a couple of explanations.

The United effort began earlier, although that is not generally known. I was spokesman for the pilots through four teleconferences in the 1985 strike, where despite the press reports, the company after spending over a $½ billion to break the union, ultimately settled for less than was on the table when the strike began. The company did not believe the union had the fortitude to hold together. They found that they did and finally caved in.

During that last meeting where everyone was feeling pretty good but bruised—a 21-day strike for pilots is difficult. It's difficult for the whole company. It took United more than 1 year to climb back to its original position so much traffic had it lost. I made the suggestion and it wasn't casual, if you look at the numbers, you fellows and your other employees ought to buy this company.

And that effort began within a few days thereafter. It was not heralded because any inclination to buy a company often drives the stock price up and the pilots knew that, but they worked at it.

PROBLEMS WITH AIRLINES

I've studied all the ESOP's that have affected all the airlines and I'd like to concentrate on airlines because I think they are a wonderful example. First of all, we have two problems with airlines. One is a well run company, but before that should come safety. Now we trust our FAA to police actions and keep airlines safe, although that's an impossible task. The employees keep the airlines safe. If they are not more concerned about safety than they are on-time arrival or cost cutting in the maintenance department, more people are going to get hurt than should happen statistically because we have, at least potentially, the best pilots and the best crews in the world, and deregulation, as you know, has put tremendous pressures on that. We've seen fines coming out for maintenance violations that weren't accidental; they were deliberate and they saved more money than the fines cost.

Seventy-eight percent, as Mr. Borman once said, of the controllable costs of airline operation is labor. Not only that, but this is a vertical market where you are worthless if you go elsewhere. A 22 year of service pilot cannot move sideways into another airline because of union rules and the way things are done. He would have to start out all over again. His interest and that of the flight attendant and machinist who come up vertically the same way in maintaining their job security is far greater than in many other industries where you can transfer laterally.

Management may come and go, but the employees structure in airlines must stay.

After the employees in Eastern got sideswiped—and I happened to be there the night that that happened, speaking for the United pilots who were on the verge of a strike and in retrospect should have—through very clandestine deals where they locked up provisions that prevented employees who own 25 percent of the airline from ever acquiring it or even protecting what they had, a backroom deal in which board members who were from the unions were excluded. Suddenly the airline was gone.

The United attempted acquisition by the pilots, which I predict will ultimately be successful—they certainly have turned second base by getting rid of some of the problems that caused them to make this move in the first place— recognized several things. Most airline ESOP's and there have been a bunch of them, are a dollar short and a day late. The airline gets in financial crisis. It has to get wage cuts. The employees want something in exchange. They get minority shares.

And except in two cases where there have been takeovers and they got their money back essentially, they wind up with the short end of the stick. And these are coerced deals. These are not borne in the open marketplace.

I think that aspect ought to be looked at. If employees are forced to give up wages that they were earning for doing the same job they were the year before because the company needs the money, that stock ought to have some protection against takeovers that ordinary stock doesn't. It ought to have a special classification where it cannot be taken over just because Frank Lorenzo gets his hands on 51 percent of the other stock and with one fell swoop and only one vote wipes out the employees who come too late to court to enjoin him and never had the chance to put their money on the table.

EMPLOYEES SEE CRISIS COMING

In the United action, this was a defensive maneuver because the employees of United could see that the crisis was coming. Management of the company, in a plan not approved or at least applauded by most of Wall Street, had decided to pull the "Statue of Liberty" play out of the bag and once again tried to hammer together hotels and cars and airplanes to build an empire. American and Pan-Am had already proven that didn't work very well.

High prices were being paid for these companies that were acquired by United and the airline started losing money. Mr. Crandall, Mr. Kolodny, Mr. Garrett with American, U.S. AIR, and Delta, made money and paid their people well, but United was working their people harder, not paying them as well, and losing money. And the danger was everywhere apparent.

The employees made the offer to take the airline out of the hands of the people who were leading it down the primrose path and protect their careers because they have nowhere else to go. That is United's story. That's what's afoot.

However, now that the chairman has been, shall we say, resigned, what do we find management doing yesterday? Selling off half of the Apollo system, a poison pill of the worst kind to frustrate a takeover by employees and protect a handful of people in the ivory tower.

Just as Mr. Lorenzo stripped out the solar system from Eastern worth $400 million for a worthless piece of paper in a corporate transfer to protect against takeover, the same is being done now. I think the people who make those decisions in those rooms ought to explain to you for whose benefit they do it. The shareholders or simply to frustrate the employees from trying to bid fairly in the open market to protect themselves?

If you would get answers to those questions with Mr. Lorenzo and Mr. Borman, who hammered this deal together in secrecy, and from the people now operating the United board, who are dreaming up more and more poison pills to prevent free marketplace action, you might get a better insight into what kind of legislative measure would be helpful to put this picture more in balance.

It is not bad for America, Senator Long saw long ago, for ESOP's to grow and flourish. It is good for America. It is particularly good for an industry where the safety of millions of Americans depends on the attitude of a few Americans with great expertise who do not need to be constantly demoralized while called upon to fly through rotten weather and sometimes with mechanical problems.

BANKS BLACKBALL ESOP

The other thing touched upon by Senator Bond which is very important—and we got around it in our two cases because we have a lot of wealth in the pension fund, a "B" fund, which could be used for collateral—the banks blackball ESOP paper. Had we not positioned ourselves in United to get the money without any banks, we could not have been a serious contender and only when we showed we could do that did conventional sources step forward.

So the problem of the equity could use a legislative device and it may be access, if the employees fully vote for it, to some of their pension moneys to put it at risk in front of the lender. That's always required and that's part of banking.

But the other would be a very strident warning in some form, either civil liability or criminal sanctions, that when a corporation that is a target of a takeover by its employees who are trying to prevent it from going down the tubes, makes an approach to a bank for a legitimate loan that would probably be granted to anyone in the business community, and the head of the corporation and the head of the bank at a "good-ole-boy" luncheon agree that that loan isn't going to be made to stop the employees cold in their tracks, severe sanctions ought to apply. There ought to be statements under oath on the bottom of the rejection form, "I have had no contact, direct or indirect, or the expression of any desire on the part of the target company to influence my decision," and that will let Mr. Giuliani find a new source of people to cart away to the hoosegow, because that goes on and it goes on every day. And I hope it is something that you can address.

Employees having a forced right to bid fairly—that did not happen in Eastern. Employees having the ability to resist a mere majority vote to strip away their shares at basement prices and some reasonable equal access—these are businesslike plans put together by smart people and they should be given fair consideration and not pushed outside the door simply because one does not happen to belong to the right racquet club as the CEO does.

Those are my views, Mr. Chairman.

[The complete prepared statement of F. Lee Bailey follows:]

STATEMENT OF F. LEE BAILEY

before the

SENATE COMMITTEE ON BANKING,
HOUSING, AND URBAN AFFAIRS

June 26, 1987

Mr. Chairman, and Members of the Committee:

My name is Francis Lee Bailey Jr., and I am a trial attorney and expert in the field of aviation. I am presently counsel to the Coalition of Eastern Airlines Employees which seeks redress for the high-handed manner in which their ownership of their company was taken from them. In addition, I am counsel to the United Airline Pilots' Master Executive Council, which is pursuing ownership of that company primarily to protect operational safety as well as the job security of all United Employees.

In addition, I am counsel to Mr. Melvin Pervais, who in 1984 arranged to sell his controlling shares in CATARACT, a large contract engineering company in Pennsylvania, to its employees. This was a friendly transaction, with no wage or benefit concessions required of the employees.

I have a professional relationship with the law firm of Keck, Mahin & Cate in Chicago, which specializes in ESOP transactions, and which accomplished one of the few hostile ESOP takeovers in memory. I also work with the Kelso Companies, which specialize in ESOP work. I have been practicing law in civilian courts for 27 years, in military courts for 33 years, and have conducted or directed litigation in every state in the United States except Montana.

My current interest in the ESOP-based purchase offers affecting United Airlines and Eastern Airlines is focused upon two aspects of that highly specialized business: operational safety and career stability. I believe that these two elements are inexorably intertwined. My reasons for this conclusion are the following:

As one who seriously considered a career with scheduled air carriers when my tour as a U.S. Marine fighter pilot was completed late in 1956, I remember with great clarity what that career offered. It was a long, slow, climb - similar to the military itself - from the position of trainee to senior captain. The hours of flight and years of experience acquired before one could command a large passenger-carrying aircraft were a proven ingredient in safe and reliable airline operations. I knew that there were old pilots and bold pilots, but few if any old, bold pilots. I knew that an aircraft was a wondrous instrumentality if you stayed ahead of it, a killer if you got behind it, and that those pilots that could only stay even with it would one day get behind it. I have been an expert on aircraft accident investigation - civilian and military - since 1955.

I am one of those who believe that to some extent congress was sold a bill of goods in the last decade when it was promised by those pushing for deregulation - former United Chairman Richard J. Ferris was prominent among them - that airline safety would not suffer if the competition were cut loose. Maintenance standards have fallen, and crew standards have suffered. Huge fines for maintenance violations at Continental, Eastern, and American have become old news. The Air Florida crash in the front yard of government demonstrated tragically that seasoned pilots cannot be created overnight. Those who believe that cost-cutting is the only way to profits in airline operations cloud our future, and aim to pay those responsible for the safety of American people, including their leaders, no more than I would pay a fledgling lawyer who comes initially to learn his craft.

To what extent does ESOP acquisition of air carriers address any of these ills? In my view, to a great extent. Perhaps no other industry can benefit more from employee participation in ownership than airlines. This is a uniquely people-driven industry. All airline companies buy the same kinds of airplanes, use the same fuel and spare parts, and - most unfortunately - serve much the same food. If true competition was the aim of deregulation, with the consumer being the ultimate beneficiary, then those who supported that dramatic change must have had in mind superior service; superior in terms of on-time reliability, courteous and professional employee-passenger relations, and no diminution whatever in safety standards. As one who travels constantly on airlines, and who nearly always regrets leaving his own plane at home, all of these hopes have failed to materialize.

Nine unsuccessful efforts of which I am personally aware make clear that one kind of ESOP in the air carrier business does little if anything to improve conditions, and that is minority employee ownership. Troubled airlines in the last ten years have used the ESOP vehicle to get tax preferences in borrowings, always allocating to employees minority stock holdings. In none of these cases have the employees "won" anything, and in most they have been taken to the cleaners financially. The most dramatic example is Eastern where the employees contributed "give-ups" in one form or another totaling 900 million for about 30% of the voting stock and four board seats. Their reward from the management whose repeated mistakes they helped to blunt? Their position was sold out from under them in secret meetings from which their board representatives were excluded; in the process, Eastern Airlines was sold to the anathema of airline employees, Texas Air, for a pittance. Their higher bid for that same stock was rejected by a board which had agreed - secretly - to entertain no other bids, whatever the amount. It is ironic indeed that the current issue of "Eastern Review", Eastern's inflight magazine, prominently features (at p. 38) a laudatory article of Gary Lynch, the "top cop" of the SEC. Had Mr. Lynch answered the call of the Eastern employees to use his highly publicized powers to investigate the circumstances of the Texas Air acquisition of Eastern, he might well have found facts which would make the current plethora of Wall Street scandals look like a children's sandbox. Eastern is the ultimate proof that ESOP plans to give employees a minority stock interest is a sour deal, period - at least in the air carrier industry.

In consideration of legislation affecting the methodology of corporate takeover attempts where employee stock interests are concerned, there are several factors which I believe the congress ought to scrutinize. I make these recommendations mindful of the fact that the whole ESOP concept is supportive of participation in the companies for which they work, and therefore an expression of legislative intent favoring that kind of ownership. It follows that if employee ownership is favored, then the protection of that ownership ought to be protected as well.

There are basically two situations where employees are concerned in takeovers when they are directly involved as owners or prospective owners. I deliberately do not address the general concerns of employees in every takeover operation - job security, relocation, etc. - since I am sure that witnesses from the organized labor sector can better address those problems.

The first scenario relates to those cases where the employees own a substantial minority of the stock - I would define "substantial" for these purposes as ten per cent of the equity of the company, whether the stock be common, voting, or preferred or some combination thereof - and a third party seeks control of the company. Takeover entrepreneurs normally have serious changes in mind when they bid for a company, and the impact of these changes can severely downgrade the value of an equity position. It is my belief that there ought to be legal constraints of tender offers which would give employee owners a right of first refusal. That is to say, no offer, whether hostile or friendly, ought to be acceptable from a third party unless the employees were unable or unwilling to match it. Such a provision would give employees some chance to protect the investment they have made, as well as their own job security. Because employees can finance the cost of takeovers through sacrifices in wages and benefits, they are positioned in a manner which ought to make any bid by them very competitive.

The second instance is only slightly different, in that it contemplates circumstances where there is no corporate "raid" in prospect or in progress, but the employees wish to make a bid for a publicly held company for reasons of their own. The United pilot's bid is a typical example, since their offer was made based upon what they saw as mismanagement of their company on a conceptual basis, tolerated by a Board of Directors which rubber-stamped every move the CEO put on the table. Particularly in industries where "job" frequently means life career, I believe that employees should be given an edge against others in making an acquisition. The tax advantages in ESOP financing presently offer part of that edge, but there are still obstacles. If the law required that upon the presentation of any formal notice by employees that they were seeking the means to acquire control of a public company, management would carry the burden of proof to show that it had not acted to obstruct that effort, but instead to give it fair consideration, much would be accomplished. The courts could prevent the digestion by the company of golden parachutes, poison pills, and other defensive ploys to protect an entrenched management. Employees in an acquisition mode could be exempted from those statutes - sure to proliferate since the Supreme Court upheld the one in Indiana - which seek to inhibit takeovers when a certain percent of the stock is held by residents of a state.

If both legal protection and encouragement for employee ownership were incorporated in new legislation relating to takeover rules where employee owners are involved or wish to be involved, I believe that the country would benefit measurably in terms of productivity, quality of goods and services, job stability, and job satisfaction. It is my earnest belief that this is certainly true of the airline industry, where I have two direct and dramatic experiences from which to judge.

F. Lee Bailey

The CHAIRMAN. Thank you very, very much, Mr. Bailey, for a very eloquent statement.

Mr. Strickland is chairman of Lowe's Companies, Inc., Winston-Salem, NC. We are delighted to have you, sir. Go right ahead.

STATEMENT OF ROBERT STRICKLAND, CHAIRMAN, LOWE'S COMPANIES, INC., WINSTON-SALEM, NC

Mr. STRICKLAND. Mr. Chairman, Senator Sanford, members of the committee, thank you. I appreciate this opportunity to vigorously endorse S. 1323 and S. 1324. I've read the sponsors' statements and the cosigners' statements and the record setting forth the reason for both bills. It's clear to me they represent a thorough understanding of the issues by the Senators on this committee.

Most importantly, the bill correctly recognizes that this is a national issue, one which should not be left to individual States or individual company charters or individual ESOP's. This is a strategic issue for the United States because it's an issue of jobs and productivity. It's an issue of U.S. competitiveness on the world scene.

Our States are taking action. Minnesota yesterday with Dayton Hudson, but a State-by-State approach wastes time and money and may have constitutional problems. A Federal response is needed.

I am chairman of Lowe's, a retail chain, with employees in 310 stores in 21 States. We were included in this book, "The Hundred Best Companies To Work For In America," because of our employee stock ownership plan. We have had substantial employee stock ownership for 26 years and I've seen it simultaneously create jobs, wealth for our employees, and a sharply increasing tax stream to the IRS from $640,000 in 1960 to more than $50 million in each of the last 3 years.

Our 15,000 employees own about 22 percent of Lowe's outstanding shares. We are a New York Stock Exchange traded company.

Also, I've been privileged to serve as a director of the Employees Stock Ownership Association here in Washington for 9 years as director, serving 2 years as president and 2 years as chairman.

At Lowe's, our management believes that we serve several constituencies, not just our shareholders. Our constituencies include our shareholders obviously, but also our employees, our customers, our suppliers, our communities, our States, and our Nation. And Lowe's management's mission is to grow the company in the balanced best interest of all our constituencies.

Since we have an ESOP, our employees are also shareholders and, therefore, they are double constituencies. Lowe's has no golden parachutes. We have no poison pill. We don't believe in greenmail. So we support these provisions of your bill, Mr. Chairman.

EMPLOYEES LEFT VULNERABLE

However, absent these tools with which to fight raiders, our employees were left vulnerable, especially to a partial or two-tier tender offer wherein control of the company could be bought for cash without buying a single share of our employees' stock and then offering them junk bonds or an unfairly lower price or offering them nothing at all.

Increasing that vulnerability of our employees is the growing institutional ownership of Lowe's stock and that could bring on what we call a "fat cat" versus "skinny cat" contest. Consider that what we call "fat cats"; ten financial institutions own 31 percent of our total shares, and that our 15,000 "skinny cat" employees own just 22 percent.

The timeframe and the investment outlook of these two groups could not be more dissimilar. We encourage our employees to take a 30-year view, to make a 30-year career commitment to Lowe's, and we have projections that show that an employee who is hired at $10,000 a year can expect, with conservative assumptions, to accumulate a retirement benefit of $400,000 after 30 years. This graph is in my testimony and it's the one Senator Long referred to.

How different is the timeframe of institutional investors about whom I have said that to Wall Street, longterm is next Friday at 4 p.m.

Beyond separate timeframes, the dice are loaded against employees. Consider that an offer and SEC filing can be made, an ad run in the Wall Street Journal, and then 10 telephone calls to 10 institutions can be made, and they own 50 percent more shares than our total employee work force. The information would have to go to our ESOP trustee and he and management would have to notify the employees in 300 locations. They would have to try to understand the offer, talk to advisers, and mail in their answers.

And in the event of a partial tender offer, for just a portion of the stock at a high price, it's clear the institutions are equipped to make those decisions with lightning speed and our employees are not. They would make those decisions before our employees ever got their mail from the postmaster.

The institutions are only making one decision representing their constituency as a shareholder. Our employees would have to make the judgment, as was brought out in the questions of Senator Long, between their interest as shareholders and their longer-term interest in their jobs. I think section 7 of your bill, Mr. Chairman, extending the tender offer time to 35 days, would be very helpful.

Now we have always had full pass through voting for our employees. Because of certain ERISA interpretations, back in 1983 we amended our ESOP and insisted that in the event of a tender offer that each employee would be allowed to vote his stock for or against the tender just the same as other shareholders. But as two-tier tender offers continue to proliferate, offering a high price for a control percentage of stock and some lower price for some lower quality security for the balance, it became clear that a fair price amendment was needed. So in 1986 we went to our shareholders recommending amendment of our charter to provide a fair price. Fortunately, that was approved and our charter was amended, but our advisers told us that our employees were still vulnerable to a partial tender by a raider who could buy control and leave our ESOP out in the cold.

And to protect our employees, we were considering adopting a shareholder rights plan, commonly known as a poison pill. But in 1987, the North Carolina General Assembly has enacted into law two important bills.

The first mandated a super majority approval and a fair price, and the second was similar to the Indiana statute recently upheld by the U.S. Supreme Court. That protects shareholders from certain abuses not addressed by fair price.

So only since May, with the action of the North Carolina General Assembly, do we feel that our employees have certain protection in their rights as shareholders. But just last week, that law was challenged in New York by the would-be acquirer of Burlington. I think this just underscores the need for Federal legislation on these matters.

RECOMMENDATIONS ON LEGISLATION

Mr. Chairman, you asked me for my suggestions for legislation that would protect the rights of employees. I have two strong recommendations. The first is to broaden the criteria by which fiduciaries should judge these offers without subjecting them to violations of ERISA.

That's answered by section 10 of your bill and I would strongly recommend that.

My second strong recommendation is for legislation requiring fair price, and legislation which would eliminate coercive partial or two-tier tender offers, which I think could always leave employee shareholders holding the bag.

We think that S. 1323 falls short by not including a fair price amendment and a ban of partial or two-tier offers. Fortunately, Senator Sanford, in his bill S. 1324, includes those provisions. It has much to recommend it, but section 9 in particular, Senator, would provide this much needed protection of employee shareholders.

Now, Mr. Chairman, I was privileged to testify before this committee in 1979 on Senator Riegle's bill for the Chrysler loan guarantees. Senator Long had made an ESOP provision a part of that consideration. I supported Senator Riegle's bill then and I'm proud to have been part of that process because I think it laid the foundation for the renaissance of the Chrysler Corp. I think these bills under consideration can help lay the foundation for the renaissance of American competitiveness and productivity in the world markets by helping management lengthen their timeframes, make productive long-range investments, and stop always having to look over their shoulder to see if some bustup raider is after them.

In 1979, Lowe's had 6,000 employees, our stock was trading at $7 per share, and we paid $22 million in income taxes. Now we have 15,000 employees, our stock is $27 a share, and last year we paid over $50 million in income taxes. We look forward to paying $100 million in income taxes. We have achieved this record by our ESOP, by being independent, by working hard, and by planning for future growth and productivity.

These bills will help many other firms in this country to do the same. I think they are landmark legislation. I congratulate the committee and the staff for all the fine work that's been done on them and we wholeheartedly support their passage and thank you for allowing me to be here today.

[The complete prepared statement of Robert Strickland follows:]

TESTIMONY

TO THE

UNITED STATES SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

FRIDAY, JUNE 26, 1987

WASHINGTON, D.C.

By
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Section 2:

Lowe's Early Employee Ownership Experience

Testimony to the United States Senate Committee on Banking, Housing and Urban Affairs, November 19, 1979
Nine Pages and Twelve Exhibits

Summary of Principal Points

1. Lowe's Companies, Inc. strongly endorses provisions of S.1323 and also S.1324.
2. This is a national strategic issue, and Federal legislation is the best solution.
3. Companies have many constituencies - not just shareholders.
4. Employee shareholders' rights are extremely vulnerable under present law and in present environment.
5. Lowe's employee shareholders have full pass through voting rights, including responding to a tender offer.
6. Fiduciaries particularly need the protection of Section 10 of S.1323, Chairman Proxmire's bill.
7. Employee shareholders and all minority groups of shareholders particularly need the protection of Section 9 of S.1324, Senator Sanford's bill.
8. This legislation is comparable to Senator Riegle's 1979 bill for the loan guarantees for the Chrysler Corporation. Then and now, United States jobs, competitiveness, and productivity are major underlying issues.

Mr. Chairman and Members of the Senate Banking Committee, good morning.

My name is Robert L. Strickland, Chairman of Lowe's Companies, Inc. I appreciate this opportunity to vigorously endorse S.1323, the Tender Offer Disclosure and Fairness Act of 1987 as introduced by Chairman Proxmire. I have read the Chairman's statement in the Congressional Record setting forth the reasons for this bill, and it is clear that this bill represents a thorough understanding of the issues by the Senators on this Committee, the bill correctly recognizes that this is a national issue, one which should not be left to individual states, or individual company charters. This is a strategic issue for the United States. Because it is an issue of jobs and productivity, it is an issue of United States competitiveness on the world scene. Some of our states are taking action, but a state-by-state approach wastes time and money, and may have constitutional problems. This Federal response is needed.

The Chairman has asked me to address specifically the issue of corporate takeovers and employee ownership. I am Chairman of Lowe's, a retail chain with thousands of employees in 310 stores in 21 states. We were included in the book "The 100 Best Companies to Work For In America", because of our employee stock ownership plan. (Exhibit A: 1-5) We have had substantial employee stock ownership for 26 years during which time I have seen it simultaneously create wealth for our employees, and a sharply increasing tax stream to the Internal Revenue Service from $640,000 in 1960 to more than $50,000,000 in each of the last three years. (Exhibit B) Our 15,000 employees own about 22% of Lowe's outstanding shares. I have been privileged to serve as a Director of the Employee Stock Ownership Association, based here in Washington, for 9 years, serving 2 years as President and 2 years as Chairman.

Lowe's management believes and understands that we serve several constituencies not just our shareholders. Our constituencies include our shareholders, but also our employees, our customers, our suppliers, our communities, our states and our nation. We view our mission as growing the company in the balanced best interest of all our constituencies.

Since Lowe's has an ESOP, our employees are also shareholders and therefore they are double constituencies.

In the recent environment of hostile takeovers, it has not been clear as to how to best balance the interests of all our constituencies.

Lowe's has no golden parachutes. We have no poison pill, and we don't believe in greenmail. So we support these provisions of S.1323, Mr. Chairman. However, absent these tools with which to fight raiders, our employee shareholders were left vulnerable to raiders and particularly a partial or two-tier tender offer wherein control of the company could be bought for cash, without buying a single share of our employees stock, and then offering them junk bonds or an unfairly lower price for their equity interests, or offering them nothing at all.

Increasing the vulnerability of our employee shareholders is the growing institutional ownership of Lowe's stock. That could bring on a Fat Cat versus Skinny Cat contest. Consider that Fat Cats, 10 financial institutions - just 10 - own 31% of our total shares and that our 15,000 Skinny Cat employees own just 22%. (Exhibit C: 1 & 2)

The time frame and investment outlook of these two differing groups could not be more dissimilar. We encourage our employees to take a 30 year view - to make a 30 year career commitment to Lowe's - and we have actuarial projections that show that an employee who is hired at $10,000 per year can expect, with conservative assumptions, to accumulate a retirement benefit of $400,000 after 30 years. The graph in my written testimony shows that most of that gain comes in the last 10 years of employment. (Exhibit D: 1,2,3)

How different is the time frame of institutional investors, about whom I have said, that to Wall Street, long-term is next Friday at 4:00.

This illustrates the economic damage that is being done to our competitive position in the world markets. Unlike Japan, prior to this bill, American managements have had to constantly look over their shoulder and constantly be concerned about short-term results, too often at the expense of long term jobs, competitiveness, research and development, and investment in better future results.

Beyond the separate time frames, and even with pass through voting to employee shareholders, the dice are loaded against employees. Consider that an offer and SEC filing can be made, an ad run in the WALL STREET JOURNAL, and then 10 telephone calls to 10 institutions can be made simultaneously, and those 10 institutions own 50% more shares than our 15,000 employees.

The information would have to go to our ESOP trustee, and he and management would have to notify the employees in 310 different locations in 21 different states, they would have to try to understand the offer, probably talk to advisors, then mail in their answer - and in the event of a partial tender offer for just a portion of the stock at a high price, it's clear that the institutions are equipped to make those decisions at lightning speed, whereas our employees are not. This highlights the short time frame of the institutions versus an employee who not only is making a decision about his stockholdings, but who also may be making a decision risking his continued employment if the raider is successful and busts up the company. Section 7, extending tender offer time from 20 to 35 days would help employee shareholders.

For 5 years Lowe's has devoted a lot of time and money in the attempt to protect our employee shareholders from a raider and a partial or two-tier bust-up offer.

We have always had pass through voting for our ESOP employees. Because of certain ERISA interpretations, in 1983, we amended our ESOP and provided that in the event of a tender offer that each employee plan member would be allowed to vote his own stock. We wanted to pass through the decision to employee shareholders so that they would be treated the same as other shareholders. We felt that would protect employees in the event of a tender offer for all shares. (Exhibit E)

However, as two-tier tender offers proliferated, offering a high price for a control percentage of stock, and some lower price or some lower quality security, or indeed not offering anything at all for the remainder of the shares, it became clear that a fair price amendment was needed. So in 1986, Lowe's went to our shareholders recommending their consent to amend our charter to provide that a fair price be offered to all shareholders, including obviously our employee shareholders. Fortunately, this was approved and our charter was amended.

However, our advisors told us that our employee shareholders were still vulnerable to a raider that would buy control, not buy the employees' stock, and leave our ESOP out in the cold, and we were considering adopting a shareholder rights plan, commonly known as a poison pill. But in 1987, the North Carolina General Assembly has enacted into law two important bills. The first is The North Carolina Shareholder Protection Act, which mandates that a fair price must be offered to all shareholders. The second, The North Carolina Control Share Acquisitions Act, is similar to an Indiana statute recently upheld by the United States Supreme Court. It protects shareholders from certain takeover abuses not addressed by fair price provisions. (Exhibit F)

Only since May of this year, with the action of our General Assembly, do we feel that our employees have protection in their rights as shareholders. Unfortunately, right now these laws are being challenged in court by a would-be acquiror. This underscores the need for this Federal legislation on these matters.

So as hostile takeovers have stepped up their intensity, Lowe's has stepped up its action. First, our Board of Directors amended our ESOP. Secondly, a larger constituency - our shareholders - had to approve the charter amendment for the fair price provision. Next, the General Assembly of North Carolina gave us and shareholders of all other North Carolina based corporations the fair price protection. Now the 100th Congress has the power, and through S.1323 the leadership initiative to provide this protection to all shareholders in the country, including all members of employee stock ownership plans.

Mr. Chairman, you asked me for my suggestions for legislation that would protect the rights of employee shareholders in a hostile takeover situation. I have two strong recommendations. The first of these is to broaden the criteria by which fiduciaries should judge these offers without subjecting them to violations of ERISA. Under ERISA, trustees and fiduciaries have been in a dilemma. Certain interpretations of that statute could require them to take an inappropriate short-term view, as opposed to the long term benefits of share ownership by employees. This first recommendation is answered by Section 10 of S.1323, which I strongly recommend.

My second strong recommendation is for legislation requiring fair price, and legislation which would eliminate coercive partial or two-tier tender offers which too often would leave employee shareholders holding the bag.

As strongly as we endorse S.1323, we feel that it falls short by not including a fair price amendment and a ban of partial or two-tier tender offers. Fortunately, a member of this committee, Senator Sanford, has introduced a bill, S.1324, which includes those provisions. S.1324 has much to recommend it, but Section 9 in particular would provide this much needed protection of shareholder rights.

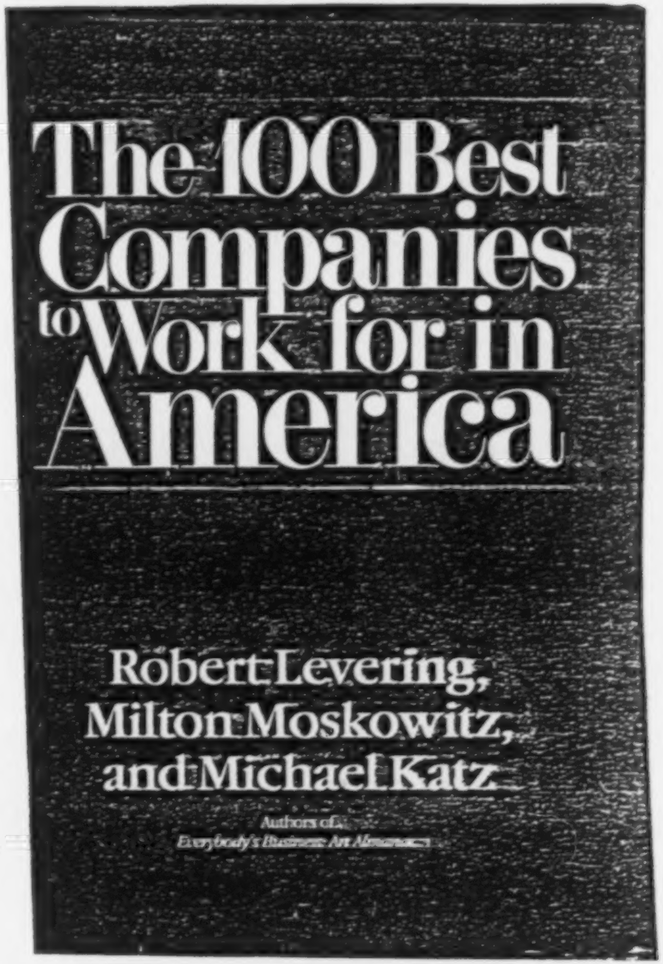
Lowe's management has been grappling with the issue of protection of our employee shareholder rights for the past 5 years. We have spent large sums for the best professional advice from attorneys, investment bankers, and proxy solicitation firms, and we have also invested untold management hours in the process. With the adoption of S.1323 and portions of S.1324, this Committee has the power to enable other corporations not to have to invest those hours and dollars which Lowe's did.

Mr. Chairman, I was privileged to testify before this Committee in 1979 on Senator Riegle's bill for the Chrysler loan guarantees. I supported Senator Riegle's bill then and am proud to have been part of that process. That bill laid the foundation for the renaissance of the Chrysler Corporation under the leadership of Chairman Iacocca. I believe your bill, Mr. Chairman, can lay the foundation for the renaissance of American productivity and competitiveness in the world markets. It will help managements to lengthen their time frames, make productive long range investments, and stop looking over their shoulder to see if some bust-up raider is after them.

In 1979 when I testified, Lowe's had 6,000 employees, our stock was valued at $7 per share, and we paid $22,000,000 in income taxes. In 1987, we have 15,000 employees, our stock is $27 per share, and last year we paid over $50,000,000 in income taxes. We look forward to paying $100,000,000 in income taxes. We have achieved this record by being independent, by working hard, and by planning for future growth and productivity. Your bill will enable many other firms in this country to do the same. This bill and Senator Sanford's bill are landmark legislation. We congratulate the Committee and the staff for all the fine work that has been done on them, and we wholeheartedly support their passage. Thank you for allowing me to appear here today.

Respectfully Submitted:
Robert L. Strickland

RLS/lm



The 100 Best Companies to Work for in America

Robert Levering, Milton Moskowitz, and Michael Katz

Authors of Everybody's Business: An Almanac

Lowe's
Companies, Inc.

LOWE'S COMPANIES, INC.

The nation's biggest lumber and hardware supply retailer. Employees: 7,300.

■■■	Pay
■■■■	Benefits
■■■	Job Security
■■■■	Chance to Move Up
■■■■	Ambience

➕ People believe they really own the company.

➖ The staff is small — and the hours are long.

Lots of people in the mountains around North Wilkesboro, North Carolina, had heard about Lowe's, even if they'd never been inside one of its stores. Lowe's is where people got rich, so the rumor went. Stories circulated of janitors retiring with a million or secretaries with several hundred thousand dollars in the bank.

Flake Johnson had "heard of all these Lowe's people making millions." At the time, about a dozen years ago, Johnson was living on a chicken farm in the Appalachian foothills and engaged in moonshining, making illegal alcohol. When his partner had a brush with the authorities because of their still, Johnson decided he "wanted to make it rich without any risk." He has been at Lowe's since 1972, working as a maintenance supervisor in the corporate office.

Johnson's motivation for joining Lowe's is typical. The stories about Lowe's profit-sharing plan are true. A $125-a-week warehouseman retired in 1975 with $660,000; a truck driver, with $413,000; and two store managers, with $3 million each. Those joining Lowe's today, however, shouldn't expect such huge payouts from the company's profit-sharing plan. Yet Lowe's still has one of the most successful, large-scale profit-sharing plans in the United States. As Johnson says, "I do not think I will get rich, but I think I will have a good savings account when I leave."

There was nothing unusual about the first Lowe's hardware store when it opened its doors for business in North Wilkesboro in 1946. But when he bought out the original owner 10 years later, Carl Buchan had a vision of creating a chain of hardware stores. He saw the stores selling their wares at a discount if they bought directly from manufacturers rather than from wholesalers. By 1960, there were 13 Lowe's stores selling hardware, home appliances, and lumber at discount prices.

Buchan also had his own ideas about how his store should be owned. Bob Strickland, Lowe's chairman, likes to tell the story of his first encounter with Buchan. Strickland went to North Wilkesboro for a job interview in 1957. He accompanied Buchan and the local store manager on a tour of the warehouse. When the group reached the area where the damaged merchandise was stored, Buchan asked the manager, "What is that?"

"It's damaged merchandise, sir."

"Look at it more closely and tell me what you see," continued Lowe's owner.

"Well, that's a damaged water pump, and a dented refrigerator, and windows with broken glass," replied the manager.

"That's not what I see when I look over there. What I see is money — my money — because I paid for it. And before the year is out, we're going to have a plan whereby part of that will belong to you and the other employees. Then when you look you'll see money, too, and you'll take better care of your money than you're doing now, and consequently you'll take better care of my money."

Buchan had instituted only the first part of his plan when he died in his sleep in 1960 at the age of 44. But his will specified that Lowe's employees, through a profit-sharing plan and trust, had the option of buying all his stock. The plan wound up with about half the shares of Lowe's stock, which meant, in turn, that Lowe's employees were the major beneficiaries as Lowe's went through a phenomenal expansion during the 1960s and 1970s and the value of Lowe's stock skyrocketed.

By 1983, Lowe's was operating 235 stores. Most are in small towns in North Carolina or nearby states, though Lowe's stores can be found in 19 states — from Pennsylvania to Florida, and from Illinois to Texas. Lowe's sold more than a billion dollars' worth of goods for the first time in 1982. The employees, through the original profit-sharing trust and an Employee Stock Ownership Plan (ESOP) that replaced it in 1978, now hold more than 25 percent of all the company's stock. And this proportion goes up every year as the company makes an annual contribution to each employee's account to buy more stock. That contribution has ranged in recent years from 12 to 15 percent of an employee's pay; Lowe's employees put up nothing. As with most ESOPs, employees can cash in their accounts only when they leave the company. Those who leave before retirement must have been there 15 years to get 100 percent of their account.

The Lowe's ESOP served as a model for ESOPs now being created all over the country because of changes in the tax laws. Lowe's chairman, Strickland, is positively evangelical on the subject. He insists that profit-sharing made the company successful, helping to motivate people. He cites figures showing that Lowe's sales ($146,045) and profits ($3,545) per employee are more than double those of the three biggest retailers (Sears, K mart, and J. C. Penney). Strickland has testified several times before congressional committees considering laws favoring ESOPs. He told us, "What is more Republican than making people capitalists? And what is more Democratic than sharing the wealth?"

Discussions with Lowe's employees support Strickland's view that the ESOP makes them feel like part owners of the business. Hence Lowe's employees have an unusual degree of commitment to the success of the enterprise. Bill Harris, a purchasing agent, explained, "We work under a management but we are part owners. So everything doesn't come from the top down. A lot comes from the bottom up. I try to give my best. The better the company does, the more money that goes in my little kitty."

Linda Blackburn is a corporate buyer. Like others we talked to at Lowe's, she finds the underlying feeling of ownership conducive to people speaking their minds. "I feel I have a lot of opportunity to say what I like and dislike," she told us. "I will not be chastised or held back for what I say."

Blackburn started working for Lowe's 15 years ago in the costing department. When she decided she did not want to be a secretary all her life, she asked to become a buyer. Though the company had never had any women buyers before (and there are still no female store managers), she was given the job. But she felt she deserved it. "You have to pay your dues around here for a while. Everything around here is not a gimme. You got to earn everything you get."

Blackburn works in the corporate office on the outskirts of North Wilkesboro (population 3,260). Despite its size, two other companies have their headquarters there: Holly Farms Poultry (along with a big chicken slaughterhouse) and American Drew Furniture (and its chair factory). The town also boasts Smithey's Department Store, Dunn's Gun Store, Lowe's Bible Bookstore and Music Center, and Lowe's Fur and Herbs Store (no connection). The outside of the Lowe's corporate offices looks like any Lowe's store. There are no windows. Executive offices tend toward the spartan. They don't believe in spending money for appearances at Lowe's. Many feel such expenditures come out of their own pockets.

Virtually everybody starts at the bottom at Lowe's. New salespeople must go through a training period of about a month in a store's warehouse where they learn all the items the store carries. Inventory control is almost an obsession at Lowe's. New salespeople learn how to type sales orders into the computer. Lowe's has been heavily computerized since the early 1960s, and it still is much more highly computerized than almost any other retail establishment. Every sales transaction — even someone buying a handful of nails — is put into the computer. Each Lowe's store has a minicomputer and

several terminals linked to a big mainframe in North Wilkesboro.

Once the salespeople hit the sales floor, they have to hustle. Their income comes strictly from commissions on sales. The rate varies according to the item sold (between about 1 and 10 percent). How much each person makes depends on what he or she (a growing number are women) sells. A typical salesperson makes $18,000 to $20,000 a year, according to Ron Butler, corporate retail sales manager, but some make as much as $80,000 to $90,000 a year.

The Lowe's system favors the aggressive. Those who do well become master sales managers, supervising other salespeople. The next step is often assistant store manager, overseeing sales to professional home builders, who account for nearly half of Lowe's sales. If people show enough promise, they can become store managers. The process can take as little as four years or more than a dozen.

Rising young store executives frequently move between Lowe's stores, especially when they are promoted to master sales manager or store manager. Larry Stone, manager of the Lowe's store in North Wilkesboro, moved from the Lowe's store in Hickory and then to Raleigh before assuming his current position. He especially appreciates the sense of being his own boss, despite Lowe's size: "It's like running your own store with somebody backing you. As a store manager, I am really allowed to wheel and deal."

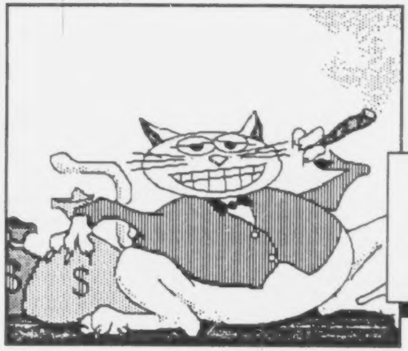
Store managers have an unusual amount of autonomy. They are free to set the sale price of any item in the store. Like their sales staff, their pay is also based largely on the profits of their store. Some of them make sizable incomes, even larger than that of company vice-presidents. Several made more than $100,000 in 1982.

Lowe's maintains a rah-rah atmosphere to keep the troops selling more nails and boards. There are lots of contests, slogans ("Bust a Billion"), and T-shirts ("Make It with a Lowe's Stud"). Until a few years ago, Lowe's had an annual hootenanny that was also its company-wide sales meeting. They were pretty wild affairs, according to all reports. Strickland said these meetings were "like a gathering of the clans." But Lowe's has grown and is no longer a North Carolina company run strictly by men from the Appalachian towns around North Wilkesboro. The 1982 annual sales meeting was held in Orlando, Florida, with merely a representative from each store attending rather than everyone descending on North Wilkesboro, as in the "good ol' days."

The Appalachian flavor still permeates Lowe's, nevertheless. On their birthdays, corporate staffers get a free lunch in the cafeteria. On Thanksgiving, everyone gets a turkey; on Christmas, a ham. For the annual picnic, employees have a "pig picking" — a pig roasted on a stick.

Lowe's Corporate Taxes Paid

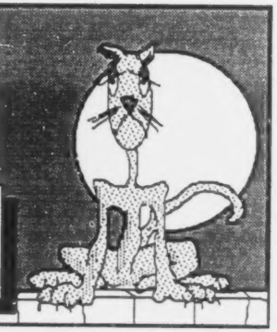
		Total
1960	(before stock acquisition)	$ 641,000
1966	(after stock acquisition)	2,496,000
1971		6,479,000
1982		22,394,000
1983		46,276,000
1984		57,633,000
1985		53,151,000
1986		$53,022,000



FAT CATS
(Institutions)

1987
10 Institutions 12,233,000 shares
31% of total
All Institutions 23,754,543 shares
60% of total

SKINNY CATS
(Employees)



1987
13,317 employees 8,788,838 shares
22% of total

Lowe's Shareholder Constituencies

1987 39,624,025 total shares outstanding

		% of Total
Institutions		
10 institutions	12,233,000 shares	31%
All institutions (323)	23,754,543 shares	60
Arbitrageurs		
	393,892 shares	1
Regular Shareholders		
5,693 people	5,172,150 shares	13
Directors & Officers		
20 people	1,514,602 shares	4
Employees		
14,783 people	8,788,838 shares	22%

Booke & Company
Consultants/Actuaries

February 5, 1981

Mr. Robert L. Strickland
Chairman
LOWE'S COMPANIES, INC.
Room 604
First Center Building
Winston-Salem, North Carolina

Dear Bob:

Here's the 30 year ESOP projections you want. They cover starting salaries of $10, $15, $20, $25, and $30K. Each has been extended for 5, 7, and 9% annual increases. Our annual assumptions are:

- 15% contribution for ESOP
- 3% growth in dividends
- 7% growth in stock value

These projections do not include any estimate of forfeitures, which Ed Spears said runs about 1.5% annually. We think that omitting forfeitures makes a good footnote to reinforce the soundness of the projections.

Sincerely,

John D. Greco
Vice President & Manager
Communications Division

JDG/rcp

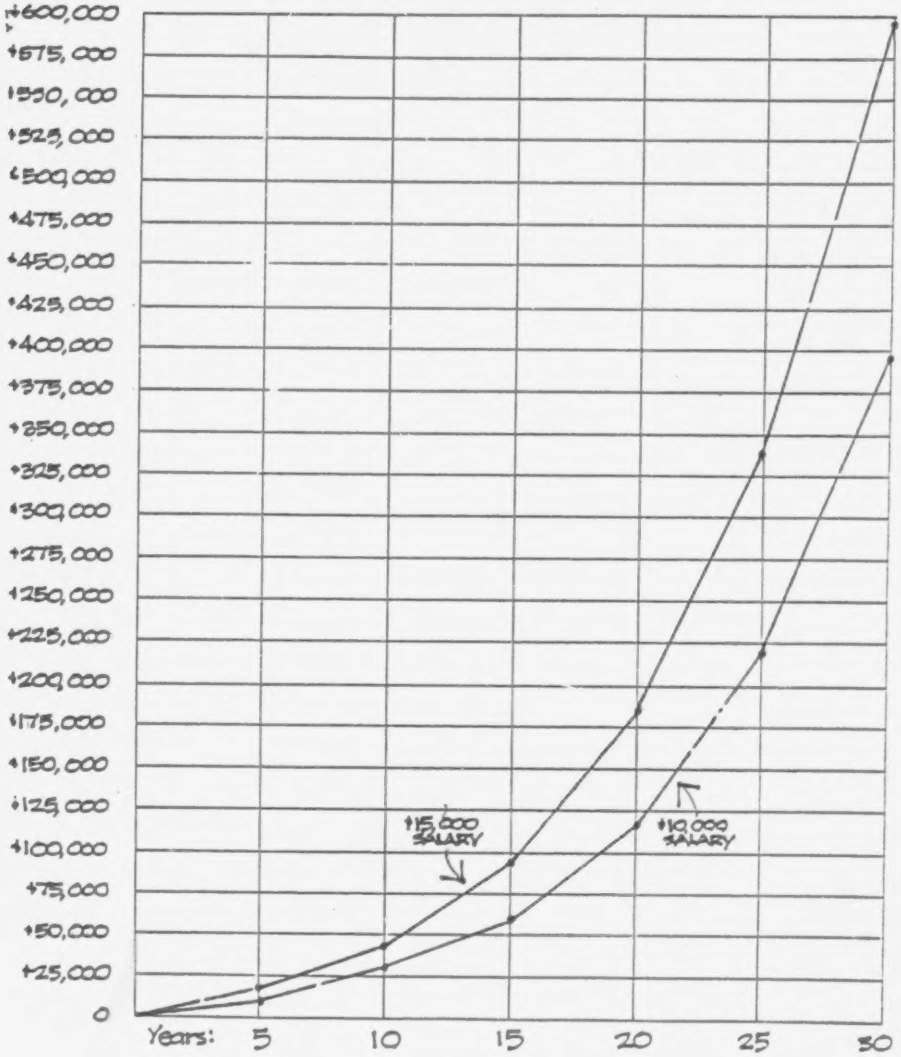
Enclosure

Post Office Box 66/Winston-Salem, North Carolina 27102/(919) 748-1120

HOW YOUR ESOP ACCOUNT CAN GROW

The table below shows how accounts can grow based on a 5% salary increase over the years. It doesn't take into consideration gains from the Trust Fund's investments, or forfeitures from members who have left the plan, all of which could increase account values even more. And, of course, greater salary increases -- above 5% per year -- would also add to your account value.

Beginning Salary	Year	Salary (5% annual increase)	Account Value
$ 10,000	1	$ 10,000	$ 1,500
	5	12,155	10,027
	10	15,513	28,945
	15	19,799	62,950
	20	25,270	122,226
	25	32,251	223,451
	30	41,161	393,824
$ 15,000	1	$ 15,000	$ 2,250
	5	18,233	15,040
	10	23,270	43,418
	15	29,699	94,424
	20	37,904	183,339
	25	48,376	335,176
	30	61,742	590,736
$ 20,000	1	$ 20,000	$ 3,000
	5	24,310	20,054
	10	31,027	57,891
	15	39,599	125,899
	20	50,539	244,452
	25	64,502	446,901
	30	82,323	787,648
$ 25,000	1	$ 25,000	$ 3,750
	5	30,388	25,067
	10	38,783	72,364
	15	49,498	157,374
	20	63,174	305,565
	25	80,627	558,626
	30	102,903	984,559



30 YEARS TO WEALTH

LOWE'S COMPANIES EMPLOYEE STOCK OWNERSHIP PLAN

RESPONSE TO TENDER OFFER BY TRUSTEE

Following 1982-1983 discussions with Wachovia Bank & Trust Company, N.A., Trustee for Lowe's Companies Employee Stock Ownership Plan (ESOP), it became clear that the trustee felt some uncertainty about appropriate action to take in the event of a tender offer for employer stock held in Lowe's ESOP. The trustee indicated that a plan amendment addressing the issue would be helpful; however, the trustee felt that there still could be circumstances under which a prudent fiduciary should accept a tender offer even if instructed otherwise by plan participants and the Management Committee which administers the plan. As of February 1, 1983, Lowe's Board of Directors and the trustee concurred upon adoption of the following amendment:

> 9.2.11 In the event that there should be a tender or exchange offer for Lowe's Stock (by a party other than the Parent Company), the response to such offer by the Trustee shall be determined as though the decision constitutes the exercise of voting rights on Lowe's Stock. Pursuant to section 9.2.9, each Member shall have the right to instruct the Trustee as to the manner in which to respond to any such offer with respect to Lowe's Stock allocated to his Lowe's Stock Account, the Management Committee shall instruct the Trustee with respect to Lowe's Stock held in the General Account Fund, and Lowe's Stock with respect to which Members do not provide instructions shall be treated in the same manner as Lowe's Stock held in the General Account Fund.

In the intervening years since adoption of the tender offer amendment, Lowe's management and the trustee have maintained a dialogue on the subject of response to a tender offer. Hostile takeovers of the past four years have made it clear that there are considerations other than stock price which must be considered when a decision is made relative to shares held in employee benefit plans. Continuity of job opportunities for employees and, ultimately, continuity of operations of the business must be considered in the balance along with stock price. Lowe's believes that no one is in a better position to make that decision than the employees whose jobs, benefits, and very livelihood are affected.

However, the trustee feels that the issue is by no means clear-cut, and that a clarifying amendment to ERISA would be very beneficial.

Edgar Spears
Secretary, ESOP Management Committee

The North Carolina Control Share Acquisition Act offers protection against four possible takeover abuses not addressed by the fair price provision in Lowe's charter:

(1) A raider could acquire a controlling position without paying shareholders the value of this control.

(2) From this controlling position, a raider could proceed to sell Company assets.

(3) After gaining control, a raider could squeeze out minority shareholders without paying full value.

(4) After acquiring a sizable position in the Company and in the process putting the Company "into play," the raider could sell out a considerable profit - a profit not realized by those shareholders who sold their shares to him.

Also, by making a hostile takeover a raider splits the shareholder group and prevents them from acting collectively through exercise of their voting power. As we have discussed in our meetings, the raider -- in effect -- disenfranchises shareholders.

The Act responds to these concerns differently than the Rights Plan, but effectively. Simply put, the Act prevents a raider from acquiring control of a North Carolina corporation without a shareholder vote -- just what raiders try to avoid. The Act permits shareholders to respond to a takeover offer collectively -- by voting as a group.

TESTIMONY

TO THE

UNITED STATES SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

MONDAY NOV. 19, 1979

WASHINGTON, D.C.

By

ROBERT L. STRICKLAND

Chairman of the Board

LOWE'S COMPANIES, INC.
P.O. Box 1111
North Wilkesboro, N.C. 28656
Telephone: (919) 667-3111

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Summary of Principal Points

1. Lowe's Companies, Inc. strongly endorses value of Employee Stock Ownership.
2. 18 years of Lowe's Employee Stock Ownership proves that the concept motivates, creates incentive, creates productivity, and creates economic growth.
3. Lowe's growth from 6 stores to 205, from $18,000,000 in sales to $900,000,000 inseparable from substantial Employee Stock Ownership.
4. Success of Lowe's and its employees publicized by FORTUNE, NEWSWEEK, and others.
5. Value of Employee Stock Ownership concept attested to by former and present Lowe's employees.
6. Lowe's experience cited by Louis O. Kelso, Esquire, widely considered as "Father" of Employee Stock Ownership concept, as "successful yardstick for all U. S. corporations to try to match."
7. Survey of benefits of Employee Stock Ownership for Stockholders who are not employees is cited.
8. Increased national Employee Stock Ownership is a powerful tactic to promote improved national economic teamwork and productivity.
9. Productivity measurements of sales and earnings per employee show Lowe's outstrips competition.
10. Lowe's expresses appreciation to Senator Proxmire and the Senate Committee on Banking, Housing, and Urban Affairs for their consideration of expansion of the Employee Stock Ownership concept.

Mr. Chairman and Members of the Senate Banking Committee -- good morning.

My name is Robert L. Strickland, Chairman of Lowe's Companies, Inc. I welcome this opportunity to vigorously endorse the unique intrinsic value of Employee Stock Ownership.

I am a businessman who believes deeply in motivation and productivity, and through 18 years with Lowe's, I have watched employee stock ownership work, and work well! From salesmen to truck drivers, from secretaries to store managers, the motivation, productivity, and achievements of Lowe's employees are a matter of historical fact and documented public record.

Lowe's is a group of retail stores, selling building materials to home builders and home owners in the Southeastern quadrant of our nation, from Indiana to Pennsylvania to Florida to Texas, and with one-fourth our stores in North Carolina.

In 1957, when Lowe's had six stores doing about $18,000,000, I went to visit the company for a job interview. Carl Buchan, the founder and owner, took me to meet the local store manager. We walked into the warehouse and over to the damaged merchandise area. He asked the manager, "What is that?" "Why, its our damaged merchandise, sir." "Look at it more closely and tell me what you see." "Well, that's a damaged water pump, and a dented refrigerator, and windows with broken glass." Buchan said, "That's not what I see when I look over there - what I see is money - my money - because I paid for it - and before the year is out, we're going to have a plan whereby part of that will belong to you and the other employees, and then when you look you'll see money too, and you'll take better care of your money than you're doing now, and consequently, you'll take better care of my money!"

In July of 1957, Buchan did just that by establishing Lowe's Profit-Sharing Plan, with membership for every single Lowe's employee, and then subsequently he gave the Plan the option to buy his stock, periodically during his life, and the remainder upon his death.

He died in 1960, and in 1961, after financial settlement with his estate and a public stock offering, Lowe's employees, through the Profit-Sharing Plan, wound up with 48% ownership of the company's stock.

Lowe's employees have always been inspired by Buchan's vision, his desire for growth, and his pioneering commitment to employee stock ownership.

Today, those six stores have grown to 205 in 19 states. Our $18,000,000 annual sales volume has grown to $900,000,000. The stock, adjusted for splits and dividends, sold for $1.02 in 1961. It's trading now for about $18.00. Many of our employees became wealthy in the process, and the success of Lowe's employee stock ownership began making news.

FORTUNE magazine in 1972 quoted our former Chairman, "We are convinced that profit sharing (and its employee stock ownership) gives our employees a direct, personal self-interest in improving the company's earnings." FORTUNE went on to say "The bounty springs from the fund's portfolio, 90% of which is invested in Lowe's common stock." (Exhibit 1)

NEWSWEEK magazine in 1975 featured Charles Valentine, a $125 a week warehouseman, who retired after 17 years with $660,000 worth of Lowe's stock and cash. (Exhibit 2) NEWSWEEK said "90% of the money is invested in Lowe's stock - and that's the secret."

The CHARLOTTE OBSERVER headlined Ferrell Bryant, a truck driver who "Retired Rich." (Exhibit 3)

In Lowe's own report to employees, we featured Mrs. Mary Marsh, a secretary, (Exhibit 4) who stated, "because it is based on Lowe's stock, it's really an incentive to the employees to help make the company grow and prosper", and also our first six figure man, Mr. Spence Bumgarner (Exhibit 5) who worked for our lumber company subsidiary for 13 years. When he retired, his $150,000 fund balance was greater than the book value of the lumber company!

The Profit Sharing Research Council ran this Cover Story, "Why Lowe's Grows" and also featured a Store Manager, a Salesman, and a Warehouseman, all three of whom retired with balances ranging from $400,000 to $2,000,000. The store manager says "It wasn't until the Plan began buying Lowe's stock that we paid attention." (Exhibits 6, 7, 8, and 9) And we were delighted when in 1976 the Honorable Louis Kelso testified before the Senate Finance Committee and told the Lowe's story of employee stock ownership success. (Exhibit 10)

Mr. Kelso is the creator of the Employee Stock Ownership concept, and has said on many occasions that Lowe's Profit-Sharing Plan was in reality an Employee Stock Ownership Plan because 80 to 90% of the fund's assets were invested in company stock.

Mr. Chairman, these success stories were created by:

- A. Employee Stock Ownership.
- B. The motivation and productivity which was thereby created.
- C. The growth in profitability which thereby ensued.
- D. The increase in the price of Lowe's stock as Lowe's incentives and growth pattern were recognized by the stock market and financial community.

But what about those shareholders who are not employees? Do they benefit from employee stock ownership? The evidence is a convincing "yes". Mr. Bert Metzger is President of the Profit Sharing Research Foundation, and his comprehensive study "Does Profit Sharing Pay" authoritatively details how all shareholders are served by employee stock ownership. I quote, "What we need today are organizational incentives - programs which can motivate all factors contributing to corporate growth-stockholders, management, and employees. Employee profit sharing (and stock ownership) is multimotivational because it focuses attention on a common goal and rewards all factors." And this has been Lowe's experience.

The charts in Exhibit 11 to this paper show that employees of profit sharing companies produced more profit per employee, more profit on sales and a higher return on shareholder equity. This resulted in higher earnings, higher dividends and higher market value per share for all shareholders, including employees. And Mr. Metzger's letter of July 5 (Exhibit 12) confirms that the high performance companies were heavily invested in their own company's stock.

Mr. Chairman, the Washington Redskins are a team made up of three teams - offensive, defensive, and specialty. Those three teams have a shared goal - to win and be successful. When one considers three important forces in this country - employees, management, and government - it's getting to be a national tragedy that instead of cooperation and teamwork towards accomplishing shared goals, we have developed adversary relationships that are getting increasingly shrill and acrimonious and non-productive. Japan and OPEC are examples of how national and international teamwork can seize economic initiative and translate it into successful, competitive growth.

I believe, sir, that improved economic teamwork must be a priority national strategy, and that increased Employee Stock Ownership is a powerful tactic by which we can implement that strategy.

Well, how do I know it works? Ho do I know that Lowe's growth wasn't influenced more by geography, or the business we're in, or management skill, etc.

In the late '50's and early '60's, there were at least five companies like ours in the Sunbelt - one in Virginia, one in South Carolina, and one in Florida, and two in North Carolina. Same geography, same business, different management of course, but not bad management. Three of the companies didn't make it on their own and sold out. The fourth company is about one-fourth our size, and they have just adopted an Employee Stock Ownership Plan. Survival of the motivated, and the productive.

We use several productivity measurements, and in our Annual Reports, we compare ourselves to major retailers and competitors in Sales per Employee, and Net Profit per Employee.

When our employee plan acquired the stock in 1961, it had a dramatic effect on both sales and profits. For the four years prior to the stock acquisition, sales per employee per year averaged $61,000 and net profits after taxes averaged $1,891 per employee per year. For the four years after the acquisition, sales declined, to an average of $73,000, but net profit per employee per year increased 19% to $2,245.

The following table lists our progress in these important productivity measurements since then:

	Per Employee Per Year		
	Sales	Taxes Paid	Profits After Taxes
1966	$ 86,468	$2,801	$3,131
1971	$ 82,952	$3,128	$3,162
1976	$123,665	$4,555	$4,595

For 1978, although our Taxes and Profits figures are not directly comparable to our prior years, due to our change to LIFO accounting, they are comparable to, and were compared with, other major retailers in our Annual Report:

	Per Employee Per Year	
	Sales	Profits After Taxes
Sears	$ 40,000	$1,948
K-Mart	$ 48,900	$1,471
Penny	$ 48,500	$1,528
Wickes	$ 97,800	$1,973
Lowe's	$136,500	$4,084

(Sources of figures for other companies: Reprinted from the 1978 FORTUNE Directory by special permission. (c) 1978 TIME, INC.

To sum up the Revenue results of a small business that has grown fairly big, and plans to keep on growing, fueled by employee stock ownership: in 1960, we paid $641,000 in taxes - in 1979 we plan to pay $25,000,000 in taxes, and we look forward to remitting $50,000,000 in taxes, and our employees will own a larger percentage of the company than they do now.

Speaking for myself as an individual, I believe:

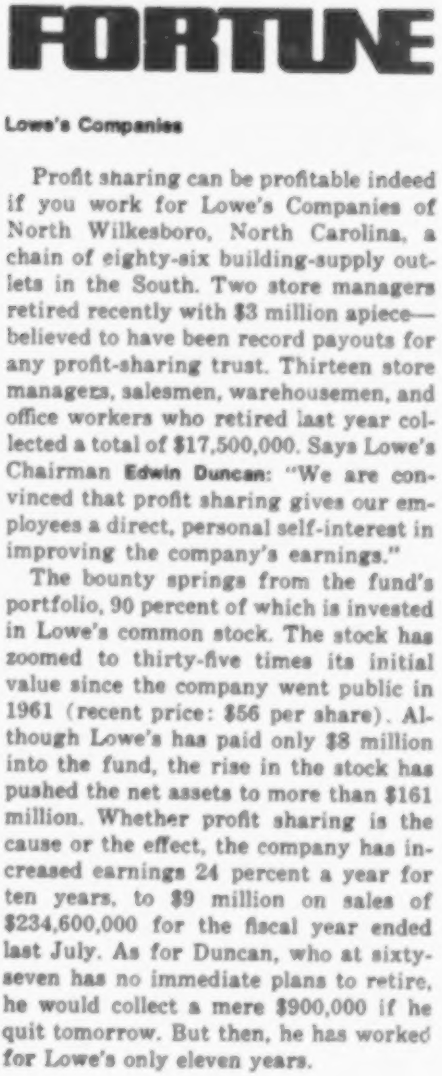
- The time for renewed national teamwork is now.
- The time for vastly increased employee stock ownership is now.
- The time for Senator Riegle's bill is now.

Mr. Chairman and Members of the Committee, Lowe's people believe in Employee Stock Ownership. We have seen it work to create incentive, productivity motivation, and wealth. We believe it is Creative Capitalism, and we are more firmly committed to the concept than ever before. We thank the Chairman and this Committee for your consideration to help make this great concept more important to this great country. Thank you, ladies and gentlemen.

Respectfully Submitted: Robert L. Strickland
Robert L. Strickland

RLS/lb

Exhibit 1:
Source: December, 1972 *FORTUNE*



FORTUNE

Lowe's Companies

Profit sharing can be profitable indeed if you work for Lowe's Companies of North Wilkesboro, North Carolina, a chain of eighty-six building-supply outlets in the South. Two store managers retired recently with $3 million apiece—believed to have been record payouts for any profit-sharing trust. Thirteen store managers, salesmen, warehousemen, and office workers who retired last year collected a total of $17,500,000. Says Lowe's Chairman **Edwin Duncan**: "We are convinced that profit sharing gives our employees a direct, personal self-interest in improving the company's earnings."

The bounty springs from the fund's portfolio, 90 percent of which is invested in Lowe's common stock. The stock has zoomed to thirty-five times its initial value since the company went public in 1961 (recent price: $56 per share). Although Lowe's has paid only $8 million into the fund, the rise in the stock has pushed the net assets to more than $161 million. Whether profit sharing is the cause or the effect, the company has increased earnings 24 percent a year for ten years, to $9 million on sales of $234,600,000 for the fiscal year ended last July. As for Duncan, who at sixty-seven has no immediate plans to retire, he would collect a mere $900,000 if he quit tomorrow. But then, he has worked for Lowe's only eleven years.

Exhibit 2:

Newsweek

BUSINESS AND FINANCE

March 31, 1975

PROFIT SHARING:

Lowe's Largesse

Charles Valentine never made more than $125 a week in his seventeen years as a warehouse laborer—yet he retired with at least $660,000. Jack A. Allen, a store manager, is 33 and thinks he may stop working in four years—with $800,000 to enjoy. And personnel manager Cecil Murray, retired at 50, can afford to lavish money on his hilltop mansion or spread it around when he goes to the racetrack, since his retirement nest egg came to $3.5 million.

The three men did not save, win or inherit their retirement fortunes, but they did share one break. All three went to work for the Lowe's Companies, Inc., of North Wilkesboro, N.C., a building-supply chain that claims to have the richest profit-sharing fund in the U.S. on a per-capita basis. More than 50 Lowe's employees have retired with an equity in six figures. Says Murray, one of a score of millionaires the program has produced: "When you work all your life and all of a sudden you don't have to work, it's fantastic." Valentine, the son of a tenant farmer, now owns a dairy farm, two cattle farms and two houses. "I never believed it would happen," he says.

Charles Valentine on his farm: 'I never believed it would happen'

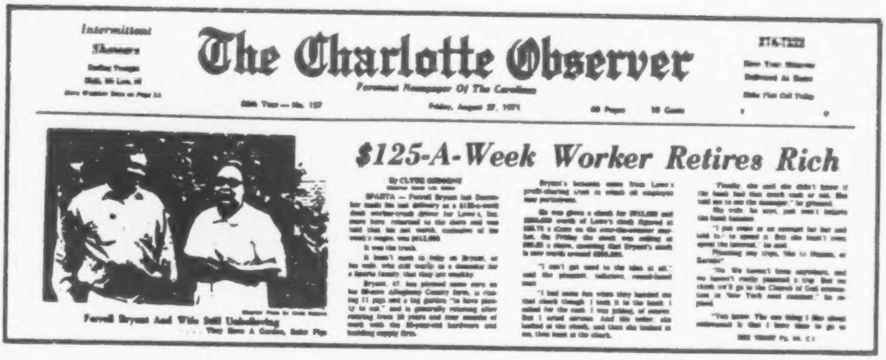
The sum that seems like a sudden windfall to Lowe's workers actually has accumulated over a period of fifteen years or more. The company, which runs 129 stores in sixteen Southern, mid-Atlantic and Midwest states, puts aside an amount equal to 15 per cent of an employee's salary each year on a store-by-store basis, if the store has met its profit goals; employees pay nothing into the fund. Ninety per cent of the money is invested in Lowe's stock—and that's the secret. The stock has performed spectacularly since it went public at $12.25 a share in 1961; allowing for splits, the value of one share soared to almost [illegible] in ten years. Even today, after the worst market shake-out in almost 40 years, the value of that initial share is still worth 25 times the offering price.

The profit-sharing fund is the biggest owner of Lowe's stock, and an employee may take his money and retire after fifteen years, regardless of age. The receipts are subject to regular and capital-gains taxes, which can be hefty, but there's still plenty left.

Stakes: The realization of what's at stake makes Lowe's 3,000 employees "profit-conscious and sales-conscious," according to Dwight E. Pardue, who administers the profit-sharing trust. "Quite frankly, we have the most dedicated employees in the world," he says, because "basically, they are working for themselves." Such incentive was the goal of H. Carl Buchan, Lowe's late co-founder, whose 880,180 shares of stock were sold to the fund at his death in 1960. Buchan had expanded Lowe's from a modest hardware business in North Wilkesboro into a modern, discount operation and figured the company would keep on growing if it were owned and controlled by those who built it. Buchan's faith has paid off. Lowe's sales have jumped from $119 million annually to $362 million over the past six years. Net earnings more than tripled during that time, from $4.6 million to $14.6 million. And Lowe's workers looked well-motivated indeed: profits per employee were two to three times better than those at a smoothly run pair of retailing giants, Sears and J.C. Penney.

—LYNN LANGWAY with JOSEPH B. CUMMING JR. in Atlanta

Exhibit 3:



Intermittent Showers

The Charlotte Observer

Foremost Newspaper Of The Carolinas

$125-A-Week Worker Retires Rich

Lowe's Profit Sharing made headlines in the Charlotte Observer.

Exhibit 4:

Source: Lowe's 1972 Profit-Sharing Annual Report

Mary Marsh… Profit Sharing the second time aound.

"You don't pay in any monev. Then when you have to leave and you receive your profit sharing, you wonder, 'Do I deserve this?' " This is how Mary Marsh felt when, after 6½ years with Lowe's as a sales secretary, she left the company when she and her husband moved to Florida. Of course, she did deserve her profit sharing money, because, just like every Plan member, her efforts had helped make that profit possible. Lowe's management feels that it is in the true American entrepreneurial spirit that those who create profits should share in them. And that's why we have the profit sharing plan.

The Profit Sharing Plan was a big incentive for Mary to return to Lowe's when she moved back into the North Wilkesboro area from Florida. Now Mary is back at work as an executive secretary and is again participating in Lowe's Profit Sharing Plan.

Mary feels that the Profit Sharing Plan is really good because participation in the Plan does not cost the members anything. "And," "she continues, "because it is based on Lowe's stock, it helps keep you interested in the company. It's really an incentive to the employees to help make the company grow and prosper."

Exhibit 5:
Source: Lowe's 1972 Profit-Sharing Annual Report

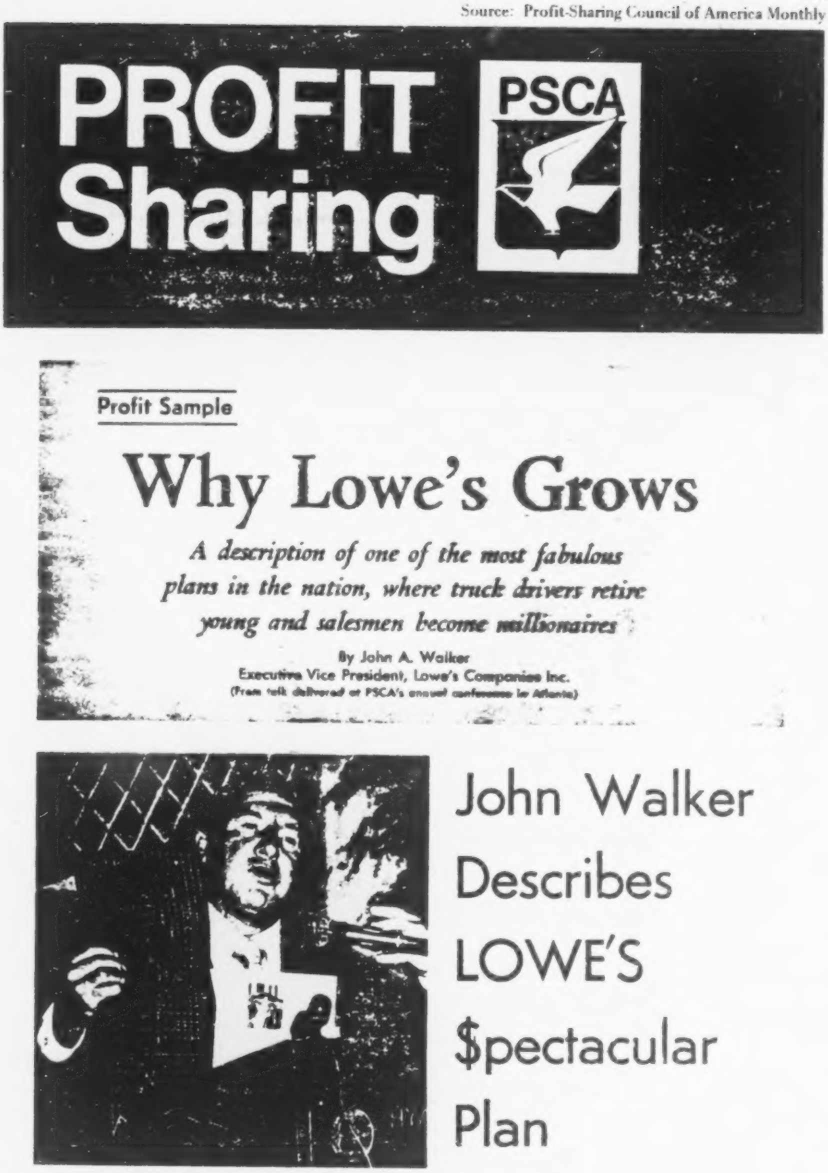
Lowe's first six-figure man, Spence Bumgarner

"They worked up this thing several years ago — kept telling us what a good deal it was — but like a doubting Thomas, I didn't think it'd amount to anything. But it sure did!" Indeed it did! J. S. "Spence" Bumgarner worked at Buchan Lumber Company as a lumber grader for 13 years; when he retired his Profit Sharing amounted to $150,000 — more than the net worth of Buchan Lumber at that time! "I was surprised to death. I wasn't figuring on getting but 50%." Because Spence was 65 when he retired, he vested 100% (forfeited none) of his profit sharing. "I'd always heard it was better to be born lucky than rich, and that was one time I believed it!" Spence had also worked for the old Oak Furniture Company for 29 years as a lumber grader.

What's Spence doing with his money? Helping his children and fixing up his home. "He let it run down for 40 years," his wife said. "Now it's going to take some time building it back up." "Yes," added Spence, "and Lowe's and Buchan Lumber are getting a lot of that profit sharing money back."

Spence's plans for the future are variable; he gardens, keeps milk cows, and works around his place. "I may work me up a hobby. I've got some wood-working tools my family gave me." Whatever, we wish Spence and his wife many years of healthy, happy retirement. Spence expressed his gratitude to Lowe's emphatically, "Tell all of them I think Lowe's is the greatest!"

Exhibit 6:
Source: Profit-Sharing Council of America Monthly Bulletin



PROFIT
Sharing

PSCA

Profit Sample

Why Lowe's Grows

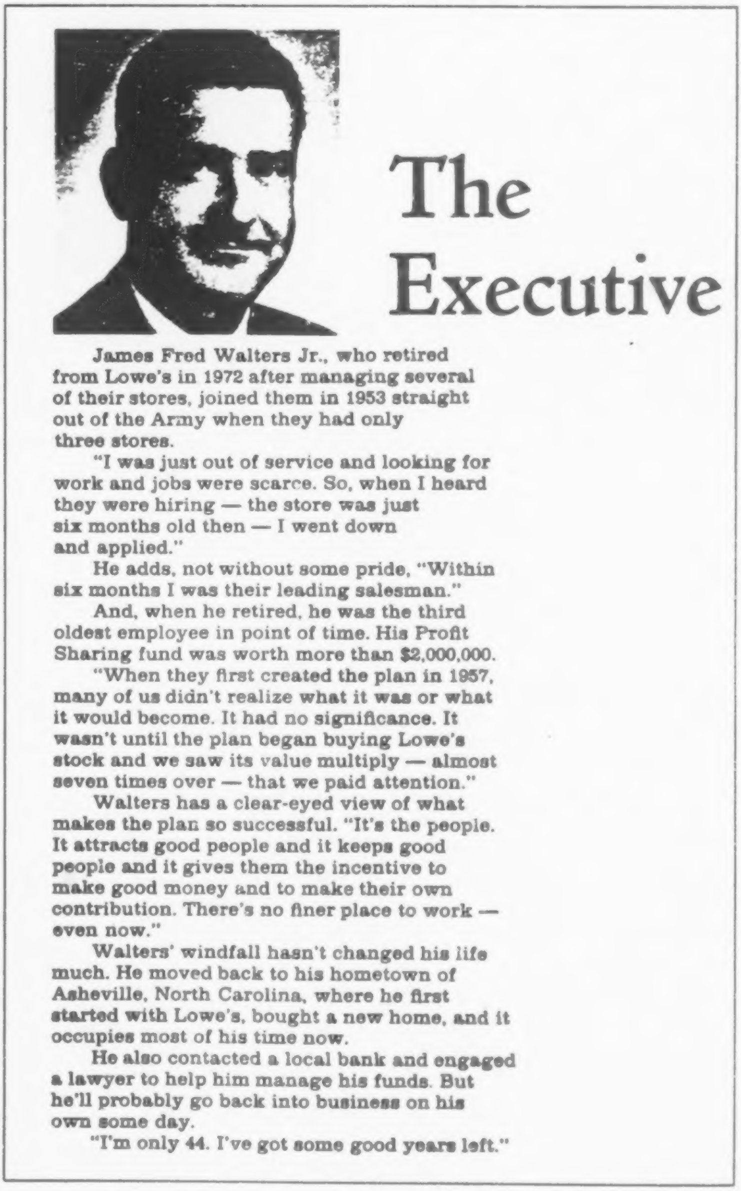
A description of one of the most fabulous plans in the nation, where truck drivers retire young and salesmen become millionaires

By John A. Walker
Executive Vice President, Lowe's Companies Inc.
(From talk delivered at PSCA's annual conference in Atlanta)

John Walker Describes LOWE'S $pectacular Plan

(Reprinted by special permission of the Profit Sharing Council of America)

Exhibit 7:
Source: Profit-Sharing Council of America Monthly Bulletin



The Executive

James Fred Walters Jr., who retired from Lowe's in 1972 after managing several of their stores, joined them in 1953 straight out of the Army when they had only three stores.

"I was just out of service and looking for work and jobs were scarce. So, when I heard they were hiring — the store was just six months old then — I went down and applied."

He adds, not without some pride, "Within six months I was their leading salesman."

And, when he retired, he was the third oldest employee in point of time. His Profit Sharing fund was worth more than $2,000,000.

"When they first created the plan in 1957, many of us didn't realize what it was or what it would become. It had no significance. It wasn't until the plan began buying Lowe's stock and we saw its value multiply — almost seven times over — that we paid attention."

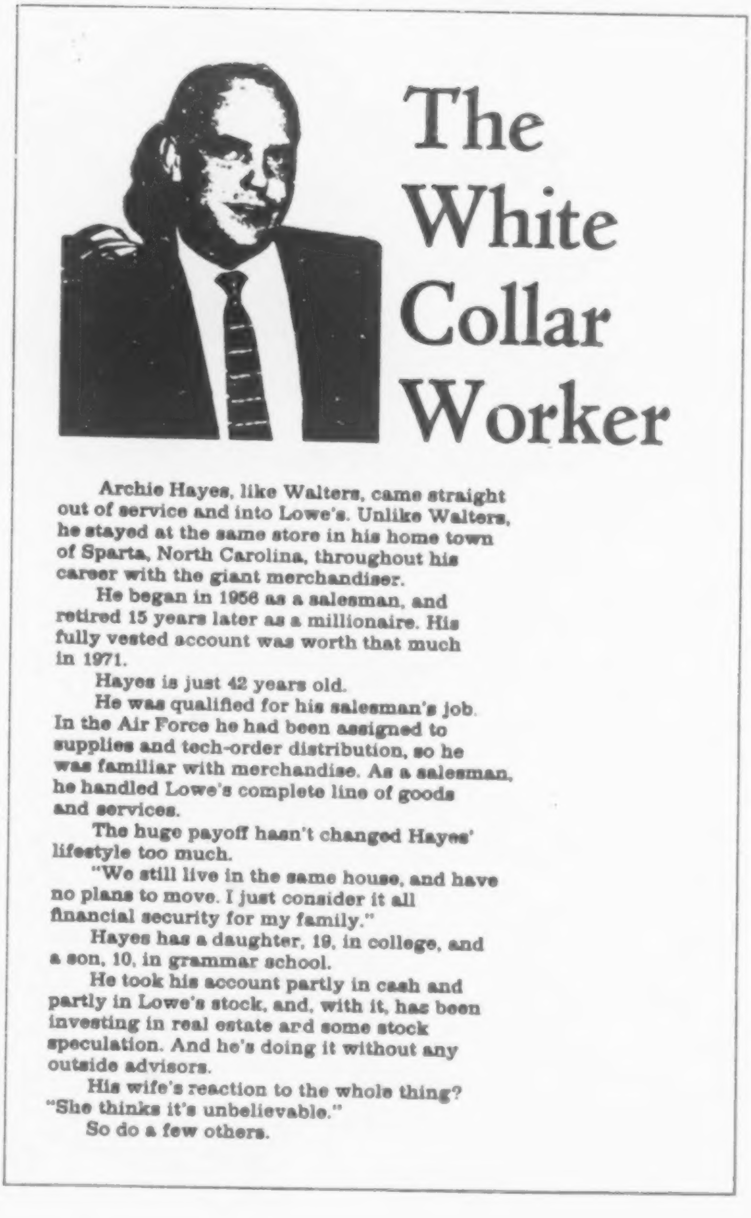
Walters has a clear-eyed view of what makes the plan so successful. "It's the people. It attracts good people and it keeps good people and it gives them the incentive to make good money and to make their own contribution. There's no finer place to work — even now."

Walters' windfall hasn't changed his life much. He moved back to his hometown of Asheville, North Carolina, where he first started with Lowe's, bought a new home, and it occupies most of his time now.

He also contacted a local bank and engaged a lawyer to help him manage his funds. But he'll probably go back into business on his own some day.

"I'm only 44. I've got some good years left."

Exhibit 8:
Source: Profit Sharing Council of America Monthly Bulletin



The White Collar Worker

Archie Hayes, like Walters, came straight out of service and into Lowe's. Unlike Walters, he stayed at the same store in his home town of Sparta, North Carolina, throughout his career with the giant merchandiser.

He began in 1956 as a salesman, and retired 15 years later as a millionaire. His fully vested account was worth that much in 1971.

Hayes is just 42 years old.

He was qualified for his salesman's job. In the Air Force he had been assigned to supplies and tech-order distribution, so he was familiar with merchandise. As a salesman, he handled Lowe's complete line of goods and services.

The huge payoff hasn't changed Hayes' lifestyle too much.

"We still live in the same house, and have no plans to move. I just consider it all financial security for my family."

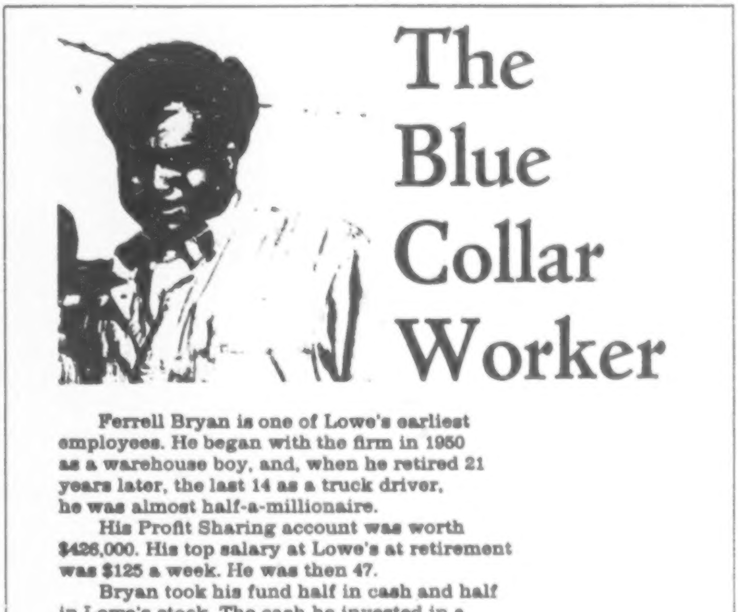
Hayes has a daughter, 19, in college, and a son, 10, in grammar school.

He took his account partly in cash and partly in Lowe's stock, and, with it, has been investing in real estate and some stock speculation. And he's doing it without any outside advisors.

His wife's reaction to the whole thing? "She thinks it's unbelievable."

So do a few others.

Exhibit 9:
Source: Profit-Sharing Council of America Monthly Bulletin



The Blue Collar Worker

Ferrell Bryan is one of Lowe's earliest employees. He began with the firm in 1950 as a warehouse boy, and, when he retired 21 years later, the last 14 as a truck driver, he was almost half-a-millionaire.

His Profit Sharing account was worth $426,000. His top salary at Lowe's at retirement was $125 a week. He was then 47.

Bryan took his fund half in cash and half in Lowe's stock. The cash he invested in a small farm near Sparta, North Carolina, and in savings accounts, and the stock he kept is now worth considerably more. Just like Lowe's, it keeps growing.

Bryan's lifestyle made a definite change, from truck driver, at which he had a near-perfect record, to farmer. He keeps some cattle, and enough crops to feed the cattle and put food on the table.

He calls the Profit Sharing plan the "best thing that ever happened in my life." Even toward the end, he couldn't believe it.

"It wasn't until some of the other old timers started to leave, and collect their accounts, that I knew it was true."

His wife had trouble believing it, too. She refused to quit her job until he had collected his account and the money was in the bank.

Bryan is still one of Lowe's best customers. "Anything I need for the farm or the home I go into the store in town. I know I'm going to get my money's worth. They've got the best goods and services around."

He ought to know. He handled a lot of it.

Exhibit 10:
Source: Louis O. Kelso, Esquire

PRESS RELEASE

Washington, D.C.--Hold For Release Until Noon, Wednesday, March 31, 1976

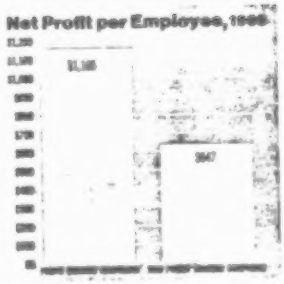
KELSO URGES SENATE TAX COMMITTEE TO MAKE AMERICAN WORKERS INTO MINI-CAPITALISTS

Louis O. Kelso testified before the Senate Finance Committee today on his proposals for restructuring the nation's tax laws to unharness America's underutilized manpower and technological potential, and to remove present tax barriers to new capital formation by making the ownership of new capital more accessible to American workers. To provide new incentives for saving capitalism and making it more relevant to our democratic ideals, Mr. Kelso called for Congress to establish as a national target for the remainder of the twentieth century the creation of opportunities for every worker, and eventually every consumer, to accumulate a tax-free capital estate of up to $500,000 over his working lifetime.

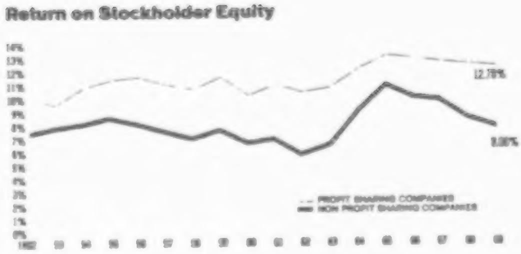
"What we are proposing is no less than the industrial counterpart to the Homestead Act", Kelso said. "Land is finite, but the potential for capital development is unlimited. Just as in 1862, when those Americans with limited means were given the chance to own and develop up to 160 acres of productive land, Americans should now be afforded the opportunity to become owners of significant holdings in our growing frontier of productive capital. By amending the nation's tax laws, we can begin to extend to every American a meaningful opportunity to carve out a personal stake in the multi-trillion dollar frontier of future capital formation."

As an example of what he hopes would be accomplished on a national scale, Kelso related the story of Lowe's Companies, Inc., a North Wilkesboro, North Carolina-based building-supply chain, where a warehouse laborer who never made more than $125 a week in the 17 years he worked for the company, retired with over $660,000 in Lowe's stock without having contributed a cent. Kelso acknowledged this as the most successful example of what employee ownership might achieve, but suggested it as a yardstick for all U.S. corporations to try to match.

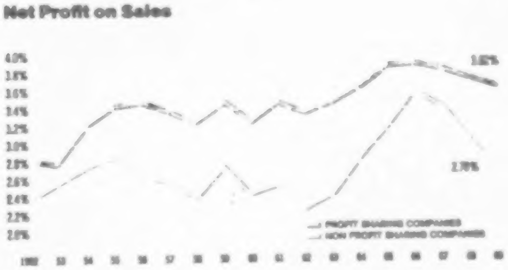
Exhibit 11:
Source: Lowe's 1971 Annual Report



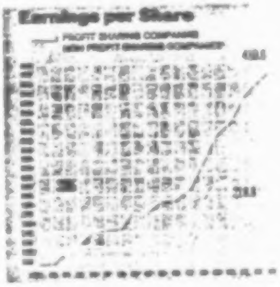
Net Profit per Employee, 1969



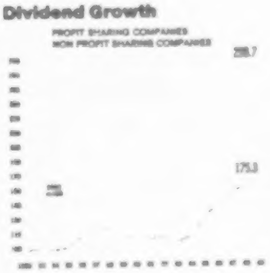
Return on Stockholder Equity



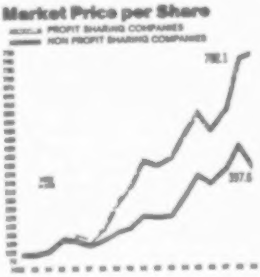
Net Profit on Sales



Earnings per Share



Dividend Growth



Market Price per Share

Exhibit 12:
Source: Bert L. Metzger, President Profit Sharing Research Foundation

PSRF

PROFIT SHARING RESEARCH FOUNDATION

1718 Sherman Avenue ■ Evanston, Illinois 60201 ■ (312) 869-8787

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Signode Corp.

July 5, 1978

Mr. Henry Church
Lowe's Companies, Inc.
Box 1111
North Wilkesboro, N.C. 28656

Dear Henry:

As a follow up to your phone call the other day I am pleased to send you and Bob some information which may be helpful in preparing appropriate testimony on the value of profit sharing and employee stock ownership.

The following items warrant your attention:

1) Our 1971 study entitled Does Profit Sharing Pay? in which the 5 companies with broad coverage profit sharing programs outperformed by substantial and widening margins the companies without profit sharing. Not so incidentally, the 5 broad coverage programs were all heavily invested in own company stock.

2) "Performance" data on 38 large profit sharing companies is compared to Fortune medians reflecting return on sales and equity. This information appears under the heading "Evidence of Superior Performance" in Vol. II of Profit Sharing in 38 Large Companies for the years 1973--1976 inclusive.

3) The prevalence and growth of profit sharing and ESOP plans--ie., current trends toward defined contribution plans, profit sharing programs and ESOPs.

4) Prevalence and extent of own company stock holdings among the 38 large profit sharing trusts. Thirty-six out of 38 invested their profit sharing funds to some extent in own company stock; 17 of 38 had from 60--100% of their portfolios in own company stock. Altogether $5.9 billion out of $9.9 billion (60%) was invested in own company stock by these 38 trusts at the end of 1976.

5) Over one million employees have a "piece of the action" through these 38 profit sharing programs.

6) The financial benefits for long-term participants under these profit sharing/share ownership programs exceeded typical pension benefits by modest-to-substantial margins in almost all cases. Twenty-seven out of the 33 companies who provided such data (82%) generated benefits under their profit sharing programs which ranged from 112% to 1011% of

the "pension standard."

You might also want to check the recent survey of ESOPs undertaken by five graduate U.C.L.A. students under the auspices of the ESOP Council of America.

I do hope that Bob will not focus in too narrowly on ESOPs as the only road to broad employee stock ownership.

Most ESOPs are funded by company contributions geared to corporate performance and, therefore, are "profit sharing" ESOPs. In addition, there is only a very thin line between an ESOP and an EPSOP. The latter is an Employee Profit Sharing and Ownership Plan. I would consider Lowe's former profit sharing program and Hallmark Cards current profit sharing program to be EPSOPs. Most of the programs in Does Profit Sharing Pay? and Profit Sharing in 38 Large Companies could also be described as EPSOPs. If a profit sharing program specifically designates that up to a certain percentage of the portfolio (eg. 25%, 50% or 100%) can be invested in own company stock, we have an EPSOP. Own company stock is consonant with the nature of such a trust and Congress, it seems, should bestow like tax incentives on EPSOPs as on ESOPs.

Bob Midkiff covers this point nicely in his article on "Helping Workers to Become Owners" in our PSRF booklet, New Horizons for Capitalism.

We hope this letter and enclosures prove useful. If we can help further or answer any questions, please don't hestitate to call on us.

Best regards,

Bert

President

BLM:mm
cc: Robert Strickland

The **Chairman**. Thank you, Mr. Strickland. We certainly strongly welcome your fine statement.

Let's say the four of us, formed the Progressive Plundering Partnership. We decide to raid your company. Now you know we can't pay for it ourselves without Jay Rockefeller and John Heinz being in our group. We aren't that rich. So we're going to have to strip your profitable stores and sell them off and probably terminate part of your work force.

You say you eschew poison pills and golden parachutes and greenmail. Mr. Bailey says in his testimony that minority employees ownership won't insulate you from the likes of us.

Tell me, Mr. Strickland, how would you defend yourself against our plundering operation?

DEFENSE AGAINST PLUNDERING

Mr. **Strickland**. We would rely on the recently passed North Carolina legislation which would require all other shareholders other than you and your consortium to lose your votes unless approved by a balance of the majority of shareholders—the majority of the shares not held by you. That would include our ESOP shareholders and, therefore, if appropriate time were given for them, and the North Carolina bill says 50 days before that shareholder meeting, I think that then our employees could have the time to decide whether they thought our record of going from $7 a share for them to $27 in the last 8 years would be a better deal to bet on for the next 8 years or whether your proposal, Mr. Chairman, would be in their best interest.

The **Chairman**. Well, if you have that kind of record, I guess you can do it, but, of course, in many cases the record might not be that impressive. That's tremendously impressive.

Let me ask you, Mr. Bailey, I have a copy here of today's Wall Street Journal. You may have read the article headlined, "Allegis scraps payout proposal of $60 a share." In the course of it it says, "But the Allegis board apparently has decided at least for the time being against the idea of proposing any form of employee ownership of United Airlines. The company said that an internal survey of United employees found what it characterized as insufficient support for such a plan."

Mr. **Bailey**. Senator, that report can hardly be accurate. The pilots who made the original offer who were willing to carry it all the way to prevent the airline from being hurt certainly strongly support it. They have put up a great deal of money in order to fund all the costs that go into this kind of effort.

I think what management is trying to say is that the unions haven't all gotten together yet on just how this should be done, but certainly the machinists are supporting it. I think the flight attendants support it strongly. But bear in mind they've got labor negotiations this fall and it's a bad time to take sides without knowing where things are going to fall out.

I have met with all three unions and I say that that statement is wrong.

What that article did not say, but it was said in USA Today, is the company plans to sell off its assets, give the shareholders a chunk of money, and then go get employee concessions. They ought to go get a good manager who could run the airline and pay the employees, like American and Delta and U.S. AIR do.

LOCKUP WAS LEGAL

The **Chairman**. Mr. Bailey, in his opinion refusing to grant an injunction against the Texas-Eastern merger, Judge James King of the Southern District Court of Florida, writes that the lockup was legal. In other words, he acknowledges, "The effect of the lockup was to prevent any other potential acquirer from obtaining enough stock to obtain control of Eastern and to prevent the board from soliciting any other bids."

He said this was legal under the Delaware law where Eastern is incorporated. The judge concluded that Eastern employees did not cite "any legal authority that obligates the board of directors to jeopardize one bid in order to give a group of employees or anyone else an indefinite amount of time in which to develop and finance an acquisition proposal."

Is the judge correct here and can you comment on that decision?

Mr. **Bailey**. Yes. As Senator Graham well knows, this is our chief judge, one of the finest we have in the Federal courts in Florida. He issued that opinion with a great deal of regret. I was there and made the argument and we didn't have the horses because that lockup was allowed to stand on legal pins.

If we had had the opportunity to fully litigate it and show what generated the lockup—and I think the manner in which it was done was illegal—we might have prevailed. We had no time. He had to make a decision right now. He didn't have time for discovery.

But I certainly think that there should be a legal provision that a lockup could only be used under the most strident circumstances when it alone could save a company from going under.

In this case, the lockup was done as part of a plan to put Mr. Lorenzo in charge of a great many shares at a very low price so he could literally vote himself in and everybody else out. And I think if the judge had had any precedent on which to do and any evidence, he might well have said that this lockup will fall. But we just couldn't cut it. We were a day late and a dollar short.

The **Chairman**. Now, Mr. Strickland, during hearings earlier this week we heard several opinions on the role States should play in governing their corporations. You've had interesting experiences in North Carolina, as you mentioned in your statement.

What's your view on the provision we have in the bill on States' rights to control corporate governance?

Mr. **Strickland**. I am normally a States righter, but as I stated in my testimony, I think this Federal response is needed. I think what we're going to see now is States competing with each other to attempt to be a corporate haven and attract corporations from one place to another. That's not going to do anything except waste time and money of State legislatures and lawyers' fees for corporations trying to best protect themselves.

It's like the statement of Chairman Hartley before this committee when he said, "All the billions that have been spent on the oil takeovers haven't created a single additional barrel of oil in the country." I think this is a strategic issue.

I think it's inefficiency and I think it is appropriate for Federal legislation to speak to these issues.

The **Chairman**. Aren't there certain cases where State governance, however make sense? Traditionally, the States have chartered corporations and provide the governing framework within which they operate.

Mr. **Strickland**. Yes.

The **Chairman**. And of course, so far to date, the States have been far more constructive, in my view, in providing fairness among all stockholders and greater consideration. It is true in the Indiana case. It is true about North Carolina.

Those who take a different view have attacked that particular provision of the bill.

Mr. **Strickland**. I just don't think that the bill in these instances that it speaks to provide that much trampling on States' traditional rights to govern corporations.

The **Chairman**. Senator Graham.

WAGE CONCESSIONS

Senator **Graham**. Mr. Bailey, you made an interesting suggestion that stock which was acquired by employees as part of a larger transaction that, for instance, included wage concessions, should have a distinct classification and treatment in, among other things, a corporate takeover enterprise.

Could you elaborate on what should be the characteristics that would warrant that special classification, and in a corporate takeover situation, how you think that stock should be treated, distinct from other classifications of stock.

Mr. **Bailey**. Certainly, Senator. If I had the power so to do, I would use retrospective legislation to have visited upon the Eastern shareholders meeting of last November, so that the acquired had to carry 51 percent of all the stock, including 51 percent of the stock owned by employees. And if he didn't get both, he couldn't take over. Because the employees' stock is usually blood, sweat, and tears and not an investment decision—I am not talking about shares bought on the open market. I am talking about shares acquired for work, as almost all of these shares were. That would have frustrated this takeover.

What happened instead was that the employees were wiped out, and were it not for a little preferred stock that couldn't be taken from them by this vote, we would have no standing in court, as we are now doing, to contest the whole takeover process and try and unscramble the eggs. A difficult task, but still a foot in the door. The right to sue as a shareholder, to enforce those rights, was gone, and indeed, right now, they are trying to get out of court on the ground that we don't have any more standing, because they wiped us out.

The other thing would be that the employees could not be bound by the decision of 51 percent of the shareholders to accept the takeover bid so they would be allowed to keep what they had, in any event. This would make some of the takeovers that are done for sheer greed, much less attractive, and I think, drive those kinds of people away, because they are the kinds of people that don't do industry any good. Some raids do. Lately, not too many. But that kind of blockage is pretty effective. We have got to win employee support. Because very frankly, any raider who really wants to run a good company and wants to do so by seizing employees' assets, particularly in the airline industry, has got to be crazy.

Nobody can ever run an airline, when 90 percent of the people view the owner or control with loathing and hatred. And that's happened now twice, and the results are in the papers every day, just in the service those airlines grant.

So I think it would be in the interests of everybody, not just protecting shareholders, to protect that stake and give it some insulation by these mechanical means.

Senator GRAHAM. You referred to some of the sales of valuable assets at what allegedly have been less than full value in the two takeover situations with which you have particularly been involved.

What recommendations would you have we might incorporate in this legislation that would make it more difficult for an acquirer to use or, in a defensive method, the current ownership to use assets and the ability to sell those at less than fair market value, in order to achieve their objectives?

Mr. BAILEY. Well, we have two distinct cases. In one case, the asset is being sold at very little value from one corporation to the other, both with the same parent. It is a sham transaction. In the other case, the asset is being sold probably for 50 percent of $1 billion, in order to cripple the pilots' ability to operate the airline, if they should ever get hold of it.

LEGISLATION TO SLOW DOWN TAKEOVERS

A quick answer as to how to legislate as to what an acquirer can and cannot sell, is not on the tip of my tongue, and I will address myself only to where employees are concerned. I would think a provision prohibiting the sale within a period of time of major assets of a corporation which the employees continue to hold stock, which assets were held when they acquired the stock—it may have been part of the inducement—would discourage raiders. Raiders have to move at blinding speed, or they don't succeed, and if you can slow them down and make these business plans jell and make sense before the ballgame is over, I think you will defeat a large part of the bad aspect of corporate takeover.

Senator GRAHAM. Thank you.

The CHAIRMAN. Could you recommend some legislative language along that line? It would be very helpful.

Mr. BAILEY. Yes. A prohibition against, one, acquiring control of a company which has any employee ownership. I would start with that provision. Using any substantial asset of that company, by selling it, to raise cash, if that was an asset that was there when the employees bought in, and they probably relied on it when they bought in, for a period of 2 years, 3 years, or whatever. Because most of these deals won't fly, unless they can buckle them together on the back end by selling off these assets within 90 to 180 days or at least go to market with it to make the lenders happy.

If you can discourage the banks and the junk bond people from putting up the money because the pay out down the road is too distant, again, you are putting a set of hobbles where they belong and giving the employees good protection. If they just are prohibited from selling those assets for a period of time, whatever in your wisdom that should be, it makes them go away.

You know, the best thing for a criminal defendant, if he's innocent, is never to be indicated. The best thing for a company is never to be raided, because it discourages raiders. The cost of defending a raid oft cripples the company in and of itself, as we have seen.

The CHAIRMAN. Thank you, Senator Graham. Senator Sanford.

Senator SANFORD. Thank you very much. Thank both of you. I am delighted to have Mr. Strickland from my——

The CHAIRMAN. Senator Sanford, there is a roll call going on. I am going to run to the floor, and when you finish, if Senator Sasser has a chance, he can go ahead, and then I will be right back.

Senator SANFORD. Well, you get on back, and I'll go vote.

The CHAIRMAN. OK. Fine. [Laughter.]

Senator SANFORD [presiding]. Let me just clarify one thing, Mr. Strickland, in the brief time that we will have to have. You seem to say that you didn't think that the States' rights ought to be maintained. I had thought from reading your testimony you thought that we should have an overriding Federal policy but that that should not deal with States and their rights to make corporate law to perhaps be more severe in some areas than the Federal Government.

Mr. STRICKLAND. That is correct, Senator Sanford. I think that we need Federal legislation setting forth some minimum standards. I believe that some of the North Carolina statutes go further than S. 1323 and S. 1324.

Senator SANFORD. Well, I have never had any problem with leaving a great deal of corporate law to States, and I think it would be a great mistake to make corporations the child of Federal legislation, totally. I think we've got a pretty good working system. And I didn't want you to misunderstand what you had said.

Mr. STRICKLAND. No, Senator, I would just say that, as I have gotten older, I have become more concerned with the Nation's rights, competitively, versus Japan and some of our competitors.

Senator SANFORD. Well, quite true, and we have got some pretty strong legislation here, but it also says that States may still play in this field.

Mr. STRICKLAND. Yes.

Senator SANFORD. Mr. Bailey, thank you so much, and especially for the specific instances. Let me just focus in the brief time we have—you've talked about ESOP's and employees and defensive measures, but let's look at it another way.

Should employees be given some preference in initiating a takeover?

Mr. BAILEY. I suggested in my statement, to this degree, Senator, and having lived in North Carolina for a number of years and working for the one employer that has not had a shot taken at it—the U.S. Marine Corps. [Laughter.]

I appreciate your situation down there.

It seems to me that employee ownership ought to be encouraged and permitted in the following steps:

When a corporation goes out to take on severe indebtedness, it is in everybody's best interests if they do that through an ESOP. It is better for the existing shareholders, because of the tax benefit provisions that are there. I think that should be made known to the employees, and just they should be invited to consider.

If the employees decide, for whatever reason, to attempt a takeover of the corporation, particularly a public corporation, I think legislation should provide that they always have the right to take it at the highest price, because they have far greater interest in it than a mere investor. And I suggested that that ought to be so. In other words, a right of first refusal at any time the corporation wants to move. And if they decide to move and put together a businesslike offer, they ought not to be defeated, except by a certain percentage above their bid.

Those two factors, I think, would give the employees powerful weapons. But not too many people—we have some, as we have seen, but not too many people want to bid against the employees who are essential to the operation of the business. Take it away from them and go in and try to get any loyalty. That's not very practical.

Senator **Sanford**. Well, thank you very much. I think I will move on, but—Senator Sasser?

Senator **Sasser**. Thank you, Senator Sanford.

I have a statement, an opening statement which will be incorporated in the record——

Senator **Graham** [presiding]. Without objection.

CORPORATE RAIDER TO FILE IMPACT STATEMENT WITH SEC

Senator **Sasser**. Mr. Bailey, I might say to you and Mr. Strickland that I am in favor of requiring a corporate raider to file a community impact statement with the SEC, when the raider makes a tender offer. And I think that this way, shareholders and communities would know whether a raider plans to highly leverage the company after it is acquired. And more importantly, they will have an idea whether the raider plans to close the plant and eliminate jobs.

I think it would be a good idea to incorporate the impact on employee ownership into this community impact statement.

I might ask you and Mr. Strickland whether you would support this concept of a community impact statement, in general.

Mr. **Bailey**. Well, I think that is a wonderful idea, but you better get it under oath, because when Continental Airlines was acquired, a very elaborate promise was made to the community of Los Angeles that the corporate base would remain there, the employees wouldn't be disrupted, et cetera. And that is when ESOP was defeated, not only by a business offer, but possibly by some legislative chicanery, as well.

Solemn promise was made that that airline was going to stay there, and the community felt comforted. That promise was broken almost immediately, and there is no remedy.

So if an environmental impact statement is going to be filed—a community impact statement is going to be filed, that is fine, provided that there is a remedy for making false statements. It is very attractive to do for some people.

Senator SASSER. I think that is a point very well made. Now what enforcement mechanism would you recommend there? In other words, an empty promise is nothing.

Mr. BAILEY. OK.

Senator SASSER. We need to have a way of enforcing that promise.

Mr. BAILEY. Well, just make the promise and the penalties of perjury and have him sign it in New York, where he knows Mr. Giuliani will be the next step, if he doesn't do well. [Laughter.]

The other thing is, I do think every time we get the impact statements, that if that is going to be done, I side with Senator Long, more good ideas have died in the bureaucracy than anywhere else in America. Don't let somebody string it out for 2 years to file a statement, because sometimes new ownership is good, and that could literally bring America to a standstill in the dynamics of corporate maneuver

Senator GRAHAM. Senator, we have 7½ minutes to vote on this measure. If you have further questions, if I could impose upon the two witnesses, if they could stay, and we will return as soon as we have voted, and you can complete your questions.

I think Senator Wirth may also have some questions that he would like to ask.

Senator SASSER. Why don't I go ahead and wind up this last question, and then I will adjourn the committee until you return or Senator Proxmire returns?

Senator GRAHAM. If the witnesses should not be here when I return, I wish to express my very strong appreciation for the very thoughtful and constructive recommendations which I think will help us fashion some provisions and defend other provisions that will advance the cause of employee ownership.

ESOP'S CALLED MANAGEMENT ENTRENCHMENT PLANS

Senator SASSER. Gentlemen, a Department of Labor Pension Administrator recently told "Business Week" that a lot of ESOP's, as he put it, are really management entrenchment plans. What do you think about this? Is there any truth in that?

Mr. STRICKLAND. I can only speak for Lowe's. This question of management entrenchment is a loaded code cord. I think that one might say Senator Long as entrenched for a long period of time, but by the voters of Louisiana. And I have been entrenched for a long time as a director of Lowe's by our voters, called our shareholders.

Now at one point of time, our shareholders, our employees, owned 51 percent. Frankly, we had to sell a portion, a large portion of our ownership of our employees, in order to repay the acquisition debt. I can sympathize with some of the comments that Senator Dodd was making earlier about the difficulties of employee ownership, employee ownership plans, acquiring the financial techniques needed to take over the company.

So I think that Counselor Bailey's suggestion to give them the rights of first refusal is good in this situation. I had not thought of that. I congratulate him for it. I would support that. I would also——

Senator SASSER. You mean giving the employees the right of first refusal?

Mr. STRICKLAND. Giving employees—an ESOP plan, the right of first refusal.

I would think, sir, that on your prior question, if I may just come back to that, on the community impact statement, we are retailers, and we view communities, quite necessarily, as a marketing company, as being one of our principal constituencies that we have to serve. I think a community impact statement would be very helpful, and I think that even if it just said this will be the community impact that we plan for the next 2 years or the next 3 years, that just stretches out that timeframe of the raider. And as Mr. Bailey has pointed out, that additional time would kill a lot of these punitive coercive deals

Mr. BAILEY. My answer to that is, yes. ESOP's, if you trace back, most, indeed, all but one that I can think of of the airline programs, management needed money. They could raise it on favorable terms by giving the employees some stock, but they never gave them enough so they could be dangerous. The stock interest ranged from 10 percent up to 32 percent. The board seats ranged from one to four. No policies of the company, with one exception, Western Air Lines did a better job than most, were really affected that much.

Supposedly, the trustee is in there to see that the employees don't give up $20 to get $1's worth of stock. And that is one protection.

And I think it is all right for employees to take a minority interest, if that is what they want. But I think, once that is done, there's got to be some kind of mechanism, so if the trouble gets in trouble again, they have the right to go the rest of the way and get control and try and manage and run it themselves, because management in some cases—Eastern is a glaring example—repeatedly strikes out and repeatedly comes back to the employees and says I've got to have more money, and then they waste it again. And I think protection is needed.

Senator SASSER [presiding]. Gentlemen, thank you very much. I am going to have to go to the floor myself and vote.

The committee will stand in recess, pending the return of the chairman. Thank you very much.

Mr. STRICKLAND. Thank you, Senator.

[Recess.]

The CHAIRMAN. Mr. Bailey, You refer to the Indiana decision upheld by the Supreme Court. I wonder if you had particular views on the role of the States in this matter.

Mr. BAILEY. I generally agree with what Mr. Strickland clarified as his answer in response to a question from Senator Sanford while you were voting, and that is, that there should be a threshold level of regulation and protection at the Federal level, without inhibiting the States, because they come from different economic postures, to do special things not in the Federal bill for their own kind of protection. Provided they don't trample on the Constitution, I see nothing wrong with it. For instance, I suspect that the protection that North Carolina has given Lowe's maybe a little stronger than all companies will get out of the Federal bill, if it passes, and I see nothing wrong with that, if it can pass legal muster.

Indiana did pass legal muster.

The CHAIRMAN. The States are—in most cases, closer to a particular, peculiar problem to that State than Federal Government. And they are very sensitive, of course, to losing employment and to the kind of drastic changes, in which whole communities lose their economic base, that follow takeovers.

So States are much more likely to be defensive. That means that you might inhibit a more efficient operation. On the other hand, it also might mean that you would provide the protection that is necessary. We can't simply look to the stockholders. They are certainly the primary consideration, but we have to consider the rights of the community, the rights of employees and the competitive capability of our economy

Mr. BAILEY. I would go perhaps a step further, Senator. Instead of merely allowing the States regulate in this area, it might not be a bad idea, if there were some encouragement for the States to do so, in terms of some benefits, some tax benefits, or whatever, because I truly think that on an international basis, the competition that we lost so badly for the last 15 years would be in much better hands if the employees woke up every day motivated, every day thinking, gee, I may make a little more money than just my salary. I think those are the healthy companies, and I think any encouragement toward a greater ESOP trend which the States can carry out more effectively at the firing line in the Federal Government, would be a good provision.

The CHAIRMAN. Very good. Mr. Strickland.

Mr. STRICKLAND. Mr. Chairman, I would like to clarify my remark on that last question. I have read section 36 in your bill, and my remarks were simply to recommend some minimum property standards, and certainly, I believe the North Carolina legislation goes way beyond, in protection, what is contemplated by either S. 1323 or S. 1324.

So I don't see any trampling on the traditional rights of States as custodians of corporate governance.

The CHAIRMAN. Thank you very much.

Mr. STRICKLAND. Thank you.

The CHAIRMAN. Thank you, gentlemen.

Our next panel is Jared Kaplan, attorney, Keck, Mahin & Cate, Chicago, IL, Randy Barber, director, Center for Economic Organizing, Washington, DC, and William Palmer, a captain, United Airlines, president, the Coalition Acting for Rights of Employees, Englewood, CO.

Now, you gentlemen are seated in alphabetical order, so we might proceed in that way.

Mr. Barber, that makes you first.

STATEMENT OF RANDY BARBER, DIRECTOR, CENTER FOR ECONOMIC ORGANIZING, WASHINGTON, DC

Mr. BARBER. Mr. Chairman, my name is Randy Barber, and am the director of the Center for Economic Organizing in Washington, DC. CEO provides a range of consulting services to labor organizations. Our clients include several departments of the AFL-CIO, a number of international unions along with many local and regional labor organizations.

I would note, however, that the opinions I express today are those of my own and are not necessarily representative of my clients.

I have been actively involved in employee ownership since 1975 and have helped unions negotiate and design ESOP's and I have assisted unions in challenging ESOP's they deem to be abusive or contrary to the interest of employees they represent. Specifically, I have been a consultant to the International Association of Machinists and Aerospace Workers, District 100, at Eastern Airlines, since 1981. In addition, I helped the Amalgamated Clothing and Textile Workers Union challenge a proposed, and ultimately unsuccessful, ESOP leveraged buyout at Scott & Fetzer.

"ESOP INDUSTRY"

While much of my testimony today will be highly critical of specific practices common to the "ESOP industry," I want to make clear my strong support for employee ownership. I believe that employees should own at least some share of their company, as a tangible recognition of the portion of their lives they have invested in their employer.

I further believe that in the long term, the goal of broadened employee ownership in American industry is being tremendously ill-served by many of the standard practices of the "ESOP industry," practices which are creating corporate structures that are fair from what anyone in the general public, I believe, would accept as real employee ownership. I fear that if the current ESOP trends continue, the promise of employee ownership will come to be viewed as a cruel illusion.

In short, I believe that the "ESOP industry" is, in many ways, fouling its own nest and in the process discrediting an idea——

I believe that, frankly, some of the practices that are going on are risking discrediting an idea that deserves broad public support and significant financial inducements provided by the Congress.

ESOP's are governed primarily through the Tax Code, because they are part of and driven by the Tax Code, the entire ESOP process is monumentally complex and fraught with special considerations, rules, tests, and loopholes.

For the average person, the terms of an ESOP are virtually impenetrable. Therefore, what some have touted as people's capitalism has almost become the exclusive preserve of ESOP efforts. The Tax Code requires a resolution from a company's board of directors to establish an ESOP, and by definition, only incumbent directors can grant life to an ESOP.

If a union, for instance, wants to mount a hostile ESOP takeover, it first has to create a corporation, which then, in turn, can create an ESOP. Thus, management and the existing owners enjoy a sort of legislated noblesse oblige with respect to the terms under which they bestow ownership to their employees, even as they use taxpayer concessions to do so.

Because directors had the sole authority to create an ESOP, they, in cooperation with top executives, typically select all of the parties involved in an ESOP transaction—the trust committee, the plan administrator, attorneys, investment bankers, valuation consultants, lenders, and so forth. Thus, incumbent shareholders, directors, and management end up, in effect negotiating with themselves over the terms of the sale of a company's stock to an ESOP, over the design and operations of the newly established ESOP and over the effective control of the resulting company.

Although there are requirements that participants be given right to vote the stock in their accounts on some issues, under some circumstances, management still has broad rights to severely limit the authority of participants in determining the future of the company.

For instance, all unallocated stock may be voted by trustees selected by management. In a leverage ESOP, this could include the majority of stock in the ESOP for a number of years. Also, closely held companies are permitted to design an ESOP in such a way that participants will never be able to vote on the board of directors or cast votes on any other shareholder issue not explicitly defined as a major issue by the Tax Code.

While Congress has recognized the ESOP as a tool of corporate finance and has allowed employers to retain exclusive control over the design of those plans, it has also emphatically asserted that ESOP's are employee benefit plans, squarely under the purview of the Employee Retirement Income Security Act, and ERISA requires the plans covered by this act be managed for the exclusive benefit of participants and beneficiaries for the exclusive purpose of providing them with benefits.

From the brief outline above, it should be clear that many ESOP's are created for purposes that, to say the least, do not live up to the spirit of ERISA's exclusive benefit and exclusive purpose standard.

In my written testimony, I discuss several examples, including the proposed Hospital Corporation of America ESOP spin-off, which I think, unfortunately one of the new ways financial tools that are out there, and I would urge that you pay close attention to that issue.

From my experience, however, the issues that emerge from the involvement in ESOP's in corporate takeovers are hugely complex and usually fraught with contradictions.

I believe that if there is one guiding principle that should be applied to these situations, it is the following:

The perspective or actual participants of an ESOP, who are the supposed beneficiaries of such a plan, should have the legal right and the practical ability to determine for themselves whether or not a particular action, plan structure or transaction is in their best interests. Unfortunately, most ESOP participants are deprived of any role in the creation, design, administration, and voting decisions of their employee stock ownership plan.

ESOP'S INVOLVEMENT IN VARIOUS ISSUES WITH TAKEOVERS

In your letter to me, you posed a number of questions, which I attempt to answer at some length, about how ESOP's are involved in various issues with respect to corporate takeovers.

I would like to simply touch on a few of the points that I make there.

First of all, I partially agree with Senator Long that the Department of Labor has some interpretations of ERISA, and now some courts have also pursued those interpretations, that make an ESOP, as opposed to more sheltered from a potential corporate raider, possibly a sitting duck, with the Department of Labor position that a trustee must make an independent decision with respect to a shareholder issue or with respect to a tender or exchange offer, and that that trustee must, if that trustee believes that the participants have elected an incorrect selection, that the trustee must override the participants' selection.

It seems to me, that is a clear problem that needs to be addressed in this legislation.

The main point is that DOL has said that a fiduciary does not get rid of fiduciary obligations simply because participants have a pass-through vote and must, essentially, second-guess any decision made by participants.

I believe that's wrong, and I believe the participants should be given the right to make their own decision.

However, I do disagree with Senator Long in his complaint that the Labor Department or somebody is involved in regulating plans, because I know the Labor Department has helped sop some very bad ESOP's in which employees would have had their pension plans stripped, would have had effectively paid a very high price for stock of the company that managements and others would have paid a very low price for. And clearly, someone has to ensure that there is a significant degree of oversight in this process, because of the abuses that are potential.

There is no doubt that ESOP's can provide benefits for employees and that ESOP's, in a takeover situation, can be very useful for them, but unfortunately, in most instances, when a company has gone into play, we are dealing with choices, neither of which are perfect. And I think the Goodyear example is a very good one, where you had Jamie Goldsmith on the one hand, and on the other hand, you had a situation where a company crippled itself to keep from being taken over.

There have been questions about what kinds of legislation should be enacted in order to further promote employee ownership. And I have several suggestions.

First of all, it seems to me that the terms, design and operation of any ESOP should be negotiated at true arm's length with the employees and their representatives. And employers proposing to establish an ESOP should be required to pay for, not select, adequate professional representation for employees and their representatives for the purposes of negotiating over the ESOP.

RIGHT OF FIRST REFUSAL

I associate myself also with the recommendations of Lee Bailey and early with Charles Bryan and other Eastern Airlines union leaders, with respect to such things as providing employees with the right of first refusal in an instance where they are significant owners in the company.

I also believe that participants should be given the right in any tax-favored ESOP to control the selection of trustees and to directly vote on all issues coming before the shareholders.

This process of the election of trustees could be run very similar to the way in which credit union boards of directors are elected now.

Also, I think that Congress should make it abundantly clear that ERISA's fiduciary standards are now designed to permit trustees to override participant elections in the case of shareholder votes and tender offers.

And finally, I believe that Congress should require that the trustees vote unallocated or unvoted ESOP shares in the exact proportion as allocated shares have been voted or tendered by participants.

One brief final comment with respect to S. 1323, section 10. I believe that instead of letting fiduciaries off the hook, which section 10(a) does by saying that if your interests aren't in conflict with participants, you don't have to tender or you can't be charged with fiduciary neglect for tendering. It seems to me, we ought to get the fiduciary out of the picture completely in those kind of situations. Instead of giving fiduciaries any kind of discretion over whether or not to tender stock or to vote stock one way or another, they should simply be required to pass through the voting rights to participants for both allocated and nonallocated shares.

Thank you very much.

[The complete prepared statement of Randy Barber follows:]

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Randy Barber, Director

STATEMENT

OF

RANDY BARBER

CENTER FOR ECONOMIC ORGANIZING

WASHINGTON, DC

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

ON

JUNE 26, 1987

Mr. Chairman:

My name is Randy Barber. I am director of the Center for Economic Organizing in Washington, DC. CEO provides a range of consulting services to labor organizations. Our clients include several Departments of the AFL-CIO, a number of International Unions, along with many local and regional labor organizations.

I have been actively involved in employee ownership since 1975, when helped found an organization designed to provide technical assistance to workers in buying existing firms or starting new ones. Over the past dozen years, I have helped unions negotiate the terms of leveraged and non-leveraged ESOPs (including full plan document language); I have advised labor organizations as they initiated their own ESOP buyout proposals; and, I have assisted unions in challenging ESOPs they deemed to be abusive or contrary to the interests of the employees they represent. Further, I have worked with unions as they have attempted to grapple with the day-to-day implications of representing workers who are also significant owners of their company, and I have helped unions propose and implement a range of innovative participation and productivity efforts. I have been directly involved in two situations involving ESOPs and leveraged buyouts that have been widely publicized: I have been a consultant to the International Association of Machinists and Aerospace Workers, District 100, at Eastern Air Lines since 1981; and, I helped the Amalgamated Clothing and Textile Workers Union challenge the proposed, and ultimately unsuccessful, ESOP leveraged-buyout of Scott & Fetzer.

While much of my testimony is highly critical of specific practices common to the "ESOP Industry," I want to make clear my strong support for employee ownership. I believe that employees should own at least some share of their company, as a tangible recognition of the portion of their lives they have invested in their employer. I further believe that, in the long term, the goal of broadened employee ownership of American industry is tremendously ill-served by many of the standard practices of the ESOP Industry -- practices which are creating corporate structures that are far from what anyone in the general public would accept as real employee ownership. I fear that if current ESOP trends continue, the promise of employee ownership will come to be viewed as a cruel illusion. In short, I believe that the ESOP Industry is, in many ways, fouling its own nest, and, in the process, discrediting an idea which should enjoy universal public support and significant financial inducements.

Today's hearings focus on the nexus of two very important social and economic issues: corporate takeovers and employee ownership. A solid grounding in both of these major phenomena is essential before the interactions of the two can be properly evaluated. Because this Committee has extensively studied corporate takeovers, I will refrain from attempting to address this issue other than to note my belief that the current takeover binge is massively wasteful and creates needless disruptions in the lives of millions of workers and thousands of communities. I will provide a brief discussion of the uses and abuses of Employee Stock Ownership Plans before addressing the relationship of ESOPs to takeovers.

Uses and Abuses of Employee Stock Ownership Plans

Although the popular perception of Employee Stock Ownership Plans comes from their highly publicized involvement in buyouts and takeovers, the overwhelming majority of ESOPs are neither leveraged nor are they significant owners of the sponsoring company. With the elimination of the PAYSOP tax credit last year, the bulk of ESOPs in existence today will probably be frozen and ultimately whither away. It appears likely, however, that new plans will be created to take advantage of the very generous incentives that Congress has provided to employers who establish ESOPs.

ESOPs are governed primarily through the tax code. Because they are part of, and are driven by, the tax code, the entire ESOP process is monumentally complex and fraught with special considerations, rules, tests, and loopholes. For the average person, the terms of an ESOP are virtually impenetrable. Therefore, what some have touted as "peoples' capitalism" has become the almost exclusive preserve of ESOP experts.

Also as a consequence of ESOPs' tax code driven nature, they have become a tool for corporate finance. While innovation may be lagging in other sectors of the American economy, there is no shortage of imagination in the financial community, as investment bankers and lawyers constantly concoct new devices to "serve" their clients (and, not incidentally, generate fees for themselves). It is abundantly clear that, in many cases, the interests of participants and beneficiaries is the least important consideration in a company's decision to implement an ESOP.

The tax code requires a resolution from a company's Board of Directors to establish an ESOP, and by definition, only incumbent Directors can grant life to an ESOP (if a union wants to mount a hostile ESOP offer, it must establish a separate corporation first, which can then create an ESOP). Thus, management and existing owners enjoy a sort of legislated noblesse oblige with respect to the terms under which they bestow ownership on their employees, even as they use taxpayer concessions to do so.

Because the Direcors have the sole authority to create an ESOP, they, in cooperation with top executives, typically select all of the parties involved in an ESOP transaction (the trust committee, the plan administrator, attorneys, investment bankers, valuation consultants, lenders, and so forth). Thus incumbent shareholders, directors, and management end up, in effect, negotiating with themselves over the terms of sale of company stock to the ESOP, over the design and operations of the newly established ESOP, and over the effective control of the resulting company.

Although there are requirements that participants be given the right to vote the stock in their accounts on some issues under some circumstances, management still has broad rights to severely limit the authority of participants in determining the future of the company. For instance, all unallocated stock may be voted by a trustee selected by management. In a leveraged ESOP, this could include the majority of stock in the ESOP for a number of years. Also, closely held companies are permitted to design an ESOP in such a way that participants will never be able to vote for the Board of Directors or cast votes on any other shareholder issue not explicitly defined as "major" by the tax code. Further, a recent GAO study found that 47% of the ESOPs it could identify had Trustees who were also officers of the sponsoring corporation.

While this self-negotiation process must stay within the four corners of the law, the ESOP Industry has been as effective as any lobbying group of this decade, progressively winning legislative provisions that more-and-more conform with the desires and interests of the sponsoring corporations and the consultants they hire.

Subject to regulations and restrictions applicable to the structure of the individual plan, ESOPs can be used by corporations for:

- o increasing cash flow;
- o taking itself private;
- o borrowing money at lower-than-available rates for a wide range of uses;
- o paying off principal on company debt;
- o making capital expenditures;
- o meeting current operating expenses;
- o partially redeeming existing shareholders;
- o purchasing stock from active or retired owners or their relatives (with the option of retaining control over the firm);
- o defending against unfriendly takeovers, by putting a block of stock in friendly hands;
- o buying out a company to take it, or keep it, private;
- o spinning off a subsidiary; and
- o replacing a pension plan.

While some ESOPs have been negotiated through the collective bargaining process, the vast majority of ESOPs have been created through unilateral management action, usually with the help of a group of outside consultants and investment bankers. When this happens, management controls all aspects of the ESOP design and operation, including (within the constraints of the law) eligibility for participation, vesting schedules, the timing of withdrawals and distributions, the exercise of voting rights, selection of the ESOP trustee.

There are a number of serious problems that have arisen with the proliferation of ESOPs. In far too many instances, the structure, motivation, and implementation of such programs appear to maximize the interests of existing shareholders, directors, and managers, while minimizing the benefits to participants. For example:

- o Deals have been put together by management and ESOP consultants in which they would receive huge compensation packages in the tens of millions of dollars which include company stock that is priced at a fraction of the price paid by employees.

- On numerous occasions, top management has insulated itself from shareholder pressures and entrenched its own position of power by directing stock into an ESOP that it alone controls.

- ESOPs are increasingly being used as part of "leveraged" buyouts which require a large amount of borrowing by a company, encouraged by the special tax preferences and incentives offered by the government. Yet, such arrangements often leave a company in a much weaker financial condition.

- Increasingly, employers are terminating existing pension plans and using the proceeds to capitalize an ESOP. Even ESOP supporters admit that ESOPs do not provide the same security as a traditional defined benefit pension plan. With an ESOP employees are, in effect, putting all their eggs in one basket. If the company goes under, workers will be stuck with reduced pensions on which to live during their retirement years. According to the ESOP Association, a 1986 survey of its membership reveals that 35 percent of the 237 companies responding had converted a profit sharing plan into an ESOP and an additional 10 percent had converted a pension plan into an ESOP.

- In addition, there are disquieting signs that ESOPs are increasingly viewed as an effective weapon to keep unions out, or to undermine existing unions by excluding represented employees from the ESOP "benefit."

While Congress has recognized the ESOP as a tool of corporate finance and has allowed employers to retain exclusive control over the design of these plans, it has also emphatically asserted that they are employee benefit plans, squarely under the purview of the Employee Retirement Income Security Act. ERISA requires that plans covered by this act be managed for the "exclusive benefit" of participants and beneficiaries for the "exclusive purpose" of providing them with benefits.

From the brief outline above, it should be clear that many ESOPs are created for purposes that, to say the least, do not live up to the spirit of ERISA's exclusive benefit and exclusive purpose standards.

A current example should serve to reinforce this point: the Hospital Corporation of America has announced its intention to sell 104 of its less profitable hospitals to a newly established company that will be majority owned by an ESOP. According to press reports, some 25,000 to 30,000 HCA employees will be effected (HCA has yet to file anything with the SEC, so the only information we have at this point is from the press). According to Business Week, the new "ESOP-controlled company will be far less attractive than its parent. HCA comes out of the deal with an enriched balance sheet and the cream of the chain's crop of general and psychiatric hospitals. The ESOP-owned company gets smaller, undiversified facilities that accounted for 35% of HCA's U.S. hospital revenues in 1986 but only 20% of that segment's profits." While HCA now has a debt-to-equity ratio of about 2-to-1, the ESOP company's ration will probably be in the 5-to-1 or 6-to-1 range. It appears that HCA will receive at least $1 billion in cash from the transaction, while the new company will be saddled with at least $1.25 billion in debt and an annual debt service in excess of $200 million. According to reports, participants will only be able to vote allocated shares in their accounts on "major" corporate issues such as mergers and liquidations, while an "independent" group of trustees, made up of appointed middle managers, will vote unallocated stock on all issues, and all stock on non-major issues such as election of the Board of Directors. While a final judgment of this proposed transaction must await further disclosures from HCA, several points can be made:

- Many HCA employees will be involuntarily shifted to a company that will be demonstrably weaker and their jobs will become more risky;

- These HCA employees will have no voice in the design of the new ESOP, in the negotiations over the price to be paid, or, apparently, in the control of the new company; and

- HCA management, under pressure for relatively poor performance, has taken this action for the benefit of existing shareholders and managers, not for participants in the new plan (HCA Chairman and Chief Executive Officer Thomas F. First, Jr. reinforced this conclusion in a statement: "We believe (the transaction) could significantly improve HCA's financial strength and future operating performance.")

Unions and Employee Stock Ownership Plans

Although critical of ESOP abuses and the generous tax breaks given to healthy companies using ESOPs, unions have cautiously begun to explore ESOP options in the face of employer economic crises. In fact, they have found the ESOP to be a valuable tool in a number of situations where workers would otherwise have lost their jobs or been subjected to a new, virulently anti-union management.

Unions encounter ESOPs under a range of circumstances. Generally speaking, these fall into the following categories:

- A union is presented with a management-initiated and designed ESOP, created for any number of reasons (lower cost financing, a leveraged buyout, repurchase of stock from a major stockholder, protection against a takeover, tax reduction, and so forth).

- During an organizing campaign, a union is confronted with either an existing ESOP or one that has just been introduced (in either case, these are frequently designed to persuade employees not to vote for a union).

- To preserve jobs or prevent an anti-union corporate raider from taking control of a company, a union initiates or willingly takes part in negotiations over an ESOP.

In 1986, the Industrial Union Department, AFL-CIO, published a list of guidelines for use by unions in negotiating ESOPs. The reader should bear in mind that these recommendations, while clearly permissible, are far above the minimum standards for ESOP design and operation required by the law. The IUD's recommendations, which I believe could serve as a starting point for future legislation that truly protects employees' interests, include:

- o Before implementation of an ESOP, one or more feasibility studies should be performed to assess the viability of the firm and its potential ability to pay retiring and terminating participants;
- o Avoid, if at all possible, the use of pension assets in funding and ESOP, or the replacement of a defined benefit pension plan with an ESOP;
- o Include the workforce in real participation and joint decision-making programs from the very beginning of the ESOP's establishment;
- o Insure that voting rights are passed through to the maximum extent feasible, and explore voting on a one-person, one-vote basis;
- o Workers should be represented on the ESOP Board of Trustees;
- o Full vesting should occur in a reasonable period of time;
- o Insure that the evaluation process for closely-held firms is fair; and
- o Include as many employees as possible as participants in the ESOP.

Questions Regarding Corporate Takeovers and Employee Ownership

From my experience, the issues that emerge from the involvement of ESOPs in corporate takeovers are hugely complex and fraught with contradictions. If there is one guiding principle that should be applied to these situations, it is the following: the prospective or actual participants in an ESOP, the supposed beneficiaries of such a plan, should have the legal right and the practical ability to determine for themselves whether or not a particular action, plan structure, or transaction is in their best interests. Unfortunately, most ESOP participants are deprived of any role in the creation, design, administration, and voting decisions of "their" Employee Stock Ownership Plan.

Chairman Proxmire has posed a series of questions with respect to corporate takeovers and employee ownership. Below, provide my perspective on the answers to these questions:

1. Are employee-owned companies treated differently in the takeover process?

There are three distinct circumstances that have to be considered: 1). Where a company is already completely employee-owned; 2). Where a company is already partially owned by its employees; and, 3). Where a proposed takeover is either implemented through or thwarted by a partial or complete employee-buyout.

1). Clearly a 100% employee-owned firm, like any closely held firm, is potentially a much more difficult target for an acquirer than a publicly traded company would be. Although this has yet to happen, however, a 100% ESOP-owned firm could become a sitting duck for a corporate raider if the current Department of Labor position on ESOP trustees' responsibilities is effectively enforced. In a nutshell, the DOL maintains that an ESOP Trustee must make an independent decision regarding a tender offer or shareholder vote, even where there is complete pass-through of voting and tender rights to participants. If the Trustee determines that the participants have been poorly informed, coerced, or just plain wrong about the financial benefits of an offer, then the DOL maintains that it would be a breach of fiduciary responsibility not to over-ride the participants' votes. The closest case of this type was the Limited's takeover bid for Carter-Hawley-Hale, where the DOL threatened to sue a bank Trustee of a C-H-H profit sharing plan if it didn't exercise its own judgment in spite of participant instructions.

2). Companies that are both partially employee-owned and publicly traded could be more immune to takeovers, assuming a) that the above-mentioned DOL position doesn't prevail in the long-run, and b) that incumbent management itself doesn't decide to sell the company and use its ability to control the vote of unallocated shares in favor of such a sale. Even though employees in a company with substantial ESOP ownership opposed a takeover, if the ESOP had a large proportion of its stock held in the loan suspense account (thus not allocated to individual participants) and if the ESOP Plan document gave the Trustee the power to vote this stock according to his or her judgment, it is quite conceivable that such a company could be easily sold to another firm. This possibility is also of concern in a 100% ESOP owned company with a large outstanding loan balance.

3). To date, most of our experience with employee ownership and takeovers stems from the establishment of new ESOPs in response to takeover threats or as part of a takeover effort. They have become a recognized tool in the takeover wars. In a number of cases, ESOPs have been established with the active participation of employees and their representatives in order to fend off a corporate raider and/or to mount a bid opposed by management. In many other cases, ESOPs have been unilaterally created by incumbent management, often in response to perceived takeover threats. While some of these efforts have clearly been in the interests of employees, many others seem to be designed not only to entrench current management, but to enrich them and their advisors as well.

How are employee ownership programs used in the takeover process?

As noted above, most of the instances where employee ownership has been used in the takeover process involve the creation of new

ESOPs as a tool for corporate defense, or, on occasion, as a mechanism for mounting a hostile bid. Typically, an employer, perceiving a takeover threat, uses the ESOP to take a company private (usually with significant minority ownership by management, investment bankers or other friendly outsiders). Examples of this type would include Raymond International, Dan River, and Scott & Fetzer (which was ultimately blocked by the Department of Labor). ESOPs have also been proposed as takeover defenses in companies that would remain publicly traded, such as Continental Air Lines (pre-Texas Air), Phillips Petroleum, and Goodyear. Hostile ESOP buyout offers have been mounted by unions at a number of airlines (TWA, Eastern, and United). The TWA buyout, where the ESOP became a 20% partner with Carl Ichan, succeeded in fending off Texas Air Corporation. The Eastern offer, as this Committee has been told, has, to date, not succeeded. The ESOP buyout proposal by United pilots, while still very much in flux, will probably result in some form of partially employee-owned airline.

The newest twist to the ESOP-in-the-face-of-takeovers phenomenon is the announced Hospital Corporation of America spin-off of its less-profitable assets into a new company that will be majority ESOP-owned. As Business Week noted, if the HCA spin-off is consummated, "other large public companies are likely to follow in its footsteps -- unloading lackluster operations on employee-owned companies that begin life burdened with huge debt."

Do these programs benefit the employees?

There is no doubt that ESOPs, used in conjunction with takeover efforts, can benefit employees. As with the rest of life, many of these situations depend on judgment calls about whether employees would be better off under a new company that succeeded in a takeover bid or under current management (even at the price of increased debt as part of an anti-takeover effort). Often, the choices that employees confront are not ideal (Goodyear is an excellent example).

It seems clear, however, that unless employees have a strong and direct voice in all aspects of the ESOP transaction, any benefits to them will be incidental at best. Likewise, it is clear that incumbent shareholders, directors, and executives have far too much discretion in determining the timing, terms, and purpose of most ESOPs used in takeover situations.

2. How are decisions regarding the institution of employee ownership programs related to or affected by takeovers?

Most ESOPs are established for purposes of providing benefits to the sponsoring corporation and its management and shareholders (tax deductions, lower rate financing, establishing a friendly market for large blocks of stock, substituting ESOPs for other types of retirement plans, and so forth). To the extent that a corporation is concerned about a possible takeover, ESOPs have been designed to help defend against such an eventuality. As noted above, whether or not this is in the interests of employees depends both on the particular terms of an ESOP and on the employees' ability to play a role in implementing it.

How are employees who own shares in the company involved in takeover decisions?

While the law requires the pass-through of voting rights in major corporate issues (such as a merger), as discussed above, it does not necessarily follow that participants will be able to effectively exercise their rights in such situations. A Trustee, following the DOL's guidance may over-ride participant votes, and, in most cases, will vote unallocated shares in the ESOP as he or she deems appropriate. In the case of the Eastern Air Lines takeover by Texas Air Corporation, Eastern's Board of Directors granted Texas Air a "lock-up" agreement that effectively precluded employee shareholders (or any others for that matter) from deciding the issue or entertaining higher offers.

Most instances where ESOPs are involved in takeovers, however, involve new plans where rules applying to participant voting rights are totally inapplicable (since, at the time of the transaction, no stock has yet been allocated). Where employees are represented by a union, the employer is obligated to negotiate over the ESOP, but many employers have either side-stepped the issue by explicitly excluding unionized employees from participation in the plan, or they have presented unions with unilateral "take-it-or-leave-it" proposals with no room or time for serious negotiations over price, terms and so forth.

3. Should any special consideration be given to employee-owners during a takeover?

I believe that employees, whether or not they are also owners, should be given special consideration during a takeover. After all, they have invested a commodity far more precious than money in their employer: they have invested their lives.

Certainly, where employees are also significant owners of a company, they should be given the right-of-first-refusal at any point that a sale, merger, takeover, or major spin-off is contemplated. The IAM's Charles Bryan has proposed that where employees have a 20% or higher stake in a company, this right should be provided. I concur with this proposal.

If so, do you have any legislative suggestions to promote employee-ownership?

Beyond giving employees a right-to-first-refusal where they own 20% or more of a company, these measures should be considered in order to ensure that ESOPs are fairly administered and enjoy broad public confidence and support:

- o The terms, design, and operations of any ESOP should be negotiated at true arms-length with employees and their representatives, and employers proposing to establish an ESOP should be required to pay for, but not select, adequate professional representation for employees and their representatives for the purposes of negotiating over the ESOP;

- o Participants should be given the right, in any tax favored ESOP, to control the selection of Trustees and to directly vote on all issues coming before shareholders (the process of selecting Trustees or a Trustee Committee should be run similar to the process of electing credit union directors); and,

- o The Industrial Union Department's guidelines for unions negotiating over ESOPs (mentioned above) should be carefully studied for other specific measures to promote fair and credible employee ownership.

4. **Is there any characteristic of an employee-owned company facing a takeover that distinguishes it from a firm without employee-ownership that should be addressed with legislation?**

- o As mentioned above, companies with 20% or more employee ownership should be required to provide employees with the right-of-first-refusal in any proposed change in corporate control or major spin-off;

- o Congress should make it abundantly clear that ERISA's fiduciary standards are not designed to permit Trustees to over-ride participant elections in the case of shareholder votes and tender offers; and,

- o Congress should require that Trustees vote unallocated or unvoted ESOP shares in the exact proportion as allocated shares have been voted or tendered.

Let me briefly comment on one aspect of S. 1323, Section 10:

Section 10(a) is, I believe, much too vague and much too weak. As I read it, a fiduciary is not required to vote in the interests of participants and beneficiaries. The fiduciary is simply let off the hook for not taking an action (tendering stock) as long as the fiduciary's interests are not adverse to those of participants and beneficiaries. I believe, first of all, that fiduciaries should not have any discretion in such cases: participants and beneficiaries should be making the decisions, not someone appointed by a company's Board of Directors. This section should simply require fiduciaries to pass-through all voting or tender rights in such a situation.

Also, Section 10(a) refers to "a tender offer or exchange offer... made pursuant to section 14(d) of the Securities Act of 1934..." This seems too narrow and vague. Rather, this section should cover any tender or exchange offer, or any proposed merger, acquisition, liquidation or other action defined as a major proposal requiring shareholder approval.

Section 10(e) should also contain much broader language to cover any significant change in corporate ownership or control. I believe that this section should be explicit in that it covers pension plan reversions that are rolled-over into an ESOP and then used to help finance a leveraged transaction. This should also cover the rollover of assets from a non-ESOP defined contribution (or money purchase) plan. While I support this provision, I believe that it would be reasonable to provide an exception for transactions that are negotiated at true arms-length by representatives of the employees.

Senator **Graham** [presiding]. Thank you very much, Mr. Barber. Mr. Palmer.

STATEMENT OF CAPT. WILLIAM H. PALMER, UNITED AIRLINES, PRESIDENT, COALITION ACTING FOR RIGHTS OF EMPLOYEES [CARE]

Captain **Palmer**. Mr. Chairman. My name is William H. Palmer. I am a pilot for United Airlines, a 22-year employee of the company, and a spokesman for Coalition Acting For Rights of Employees or CARE. It is a grassroots movement among United employees who are concerned about the impact on their future of a takeover or reorganization of the Allegis or United Corp.

Senator **Graham**. Mr. Palmer, before you proceed, I apologize, but in approximately 4 minutes, I am going to have to leave. If there is another member of the committee, I will turn the Chair over to that member. If not, we will recess until this vote is completed.

Captain **Palmer**. OK.

With me today are Deborah Palm-Egle, who is a dues-paying member of the Association of Flight Attendants and a 9-year United employee from Denver, and secretary-treasurer and director of CARE; Paul Willard, a member of the International Association of Machinists Union, a 28-year employee of United from Denver and a director of CARE; and Mira Rude, an 18-year nonunion—or noncontract employee from Chicago, who works on the crew desk.

We speak for thousands of concerned and scared employees of United, who are seeking to voice through CARE their fears about the consequences of a takeover of the Nation's largest airline. The concern is so great that in the few weeks of CARE's existence, the organization has gained support for its objectives from several thousand United employees in over 24 States. In its first meeting in Denver last week, some 700 employees attended and pledged financial and moral support. Our second meeting was two nights ago in San Francisco with similar results.

The third meeting was last night in Chicago, and again, with a large turnout.

CARE has also met with Mr. Frank Olson, chairman of Allegis, United, seeking his understanding and support of our cause. That meeting was positive and communications will continue.

We also want to make it clear, Mr. Chairman, that we have no ties with any union nor with management. We are not anticompany nor antiunion. Many of the friends and supporters of CARE belong to the several unions representing United employees, many are noncontract employees and many are even management people.

I give you this background on CARE, since we are a new group and relatively unknown outside of United, and we realize that you need to know who we are and represent.

We very much appreciate this opportunity to appear before this distinguished committee.

Let me say at the outset, sir, that we recognize that any legislation that might result from these important hearings will not, more than likely, help United employees. We feel that the events are moving too swiftly in the Allegis or United situation to help us with our problem, but we do feel that the concerns and fears of United employees at this time, may be helpful to you in your deliberations, so that other employees of other companies who will follow us, facing the same threatening situation, will have the protection of any legislation that might come out of these hearings.

Allegis, as you know, has been under active "play" on the stock market for the last 2 months or so.

Senator **Graham**. Mr. Palmer, I apologize, but as you are getting ready to start with your specific analysis and recommendations, I think this would be a time to recess. We will reconvene when we complete this vote, and we are able to return.

Captain Palmer. That will be fine.

Senator **Graham**. I apologize for this interruption.

[Recess.]

The **Chairman**. Mr. Palmer, I understand you were part way through your testimony. And so go right ahead.

Captain **Palmer**. I will try and pick up where I left off here.

Allegis, as you know, has been under active "play" in the stock market in the last 2 months or so. The Coniston partners, Jay Pritzker, perhaps Marriott and others have been involved, as well as ALPA. And it was ALPA, the Air Line Pilots Association, which began the process a few months ago with an offer to buy United from Allegis for $4.5 billion. With the help of Wall Street advisers, ALPA informally made an offer to buy and operate United.

The ALPA proposal, which we understand has never been officially put on the table, nor have the full details been made available to the public, would result, as nearly as our financial advisers can determine, in such a highly leveraged position for the company, that it would seriously jeopardize its survival and the future of its employees. The debt would be staggering and harmful to all employees.

We are not here to attack ALPA. We use this illustration as but one example of how employees in a takeover can end up powerless and with no voice in their own future.

ALPA BUYOUT STRATEGY

The ALPA buyout strategy, as we understand the facts, was conceived at the Master Executive Council level, which is a committee of 5 or so who run the union. Their Wall Street advisers assisted in this effort. The plan was never submitted to the membership of ALPA nor was the plan discussed with members of the machinists union or flight attendants union or with the nonunion employees.

The heart of the ALPA financing plan, which would enable them to take control of United, is an employee stock ownership plan, an ESOP. Not one single employee was asked if he or she would be willing to be part of an ESOP and accept the financial risk of that takeover plan.

We don't think that a system which permits the misuse of the ESOP, denying employees the right to vote on the proposition, is a fair and democratic one. We are not against ALPA or ESOP's per se but against a permissive arrangement which permits a minority to use the ESOP as a device to impose their will on a majority.

The employees we speak for are realists. They understand that airline deregulation is here to stay, that it serves the consumer best. We understand the highly competitive nature of our industry, that costs must be driven down and productivity pushed up. They know that their pay and benefits are vulnerable in any takeover. We seek no legislative action that would impede the free market forces from reaching their efficient best.

We do think, however, that there are questions of basic democratic fairness in plans such as the ALPA proposal. Under their plan, and in order to service the enormous debt they would incur in the buyout, all employee wages would be cut up to 25 percent. Layoffs could result, pensions would be put at some risk and pension payouts perhaps amount to less than employees had planned.

We do think those planned pay cuts and layoffs are an excessive responsive to an excessive debt load, but the issue of great concern to us and the issue we believe is of concern to this committee, is one of pension rights and the use of an ESOP to take control of a company without due democratic process.

That situation is much like the condemned to buy the bullets for his own firing squad.

REGULATE ESOP'S

Permit us to suggest an idea, perhaps not new, which might help solve some problems such as the United employees now face. If you choose to more closely regulate ESOP's consider the following:

Require an affirmative vote of all employees of a company before allowing an ESOP to be put into effect. This would be designed to prevent a minority of employees from initiating an ESOP, such as ALPA is attempting to, which would offer special benefits to that minority, while at the same time, increasing the risk of job loss or the need for unreasonable wage and benefit concessions from all other employees who are the majority.

And Mr. Chairman, I would like to delete suggestion No. 2 in my printed testimony, due to previous discussions here this morning.

This is only an idea, Mr. Chairman. We are not experts in law or politics. We operate airplanes for a living. We love our company and we want to see it prosper and grow. We accept the realities of a deregulated marketplace. We only ask for a level and democratic playing field, and we seek to do our work for an important part of the country's critical transportation industry.

At the moment, the employees of United Airlines do not feel that the ESOP, as it would be applied to the proposed takeover of our company by ALPA and which would place our pensions in question is either fair or level or in keeping with the democratic principles.

We think that it is an issue not unlike the now-accepted American idea of "one man, one vote."

I wish to thank you, Mr. Chairman, and the committee for having us come here this morning and express our opinions.

[The complete prepared statement of Captain William H. Palmer follows:]

TESTIMONY BY
CAPTAIN WILLIAM H. PALMER
UNITED AIRLINES SENIOR PILOT
AND SPOKESMAN FOR
THE COALITION ACTING FOR RIGHTS OF EMPLOYEES (CARE)
BEFORE THE SENATE BANKING COMMITTEE HEARINGS
WASHINGTON, DC; JUNE 26, 1987

Mr. Chairman, my name is William H. Palmer. I am a senior pilot of United Airlines, a 22-year employee of the company, and spokesman for the Coalition Acting for Rights of Employees, or CARE, a grassroots movement among United employees who are concerned about the impact on their future of a takeover or reorganization of the Allegis Corporation.

With me here today are: Deborah Palm-Egle, a dues payer of the Association of Flight Attendants, a nine year United employee from Denver, and secretary-treasurer and director of CARE; Paul Willard, a member of the International Association of Machinists union, a 28-year employee of United from Denver, and a director of CARE; and Mira Rude, an 18-year non-contract employee from Chicago, who works on the crew desk.

We speak for thousands of concerned and scared employees of United who are seeking to voice through CARE their fears about the consequences of a takeover of the nation's largest airline. The concern is so great that in the few weeks of CARE's existence, the organization has gained support for its objectives from several thousand United employees in 24 states. In its first meeting in Denver last week, some 700 employees attended, and pledged financial and moral support. Our second meeting was two days ago in San Francisco with similar results. The third meeting was last night in Chicago, again with a large turnout.

CARE has also met with Mr. Frank Olson, chairman of Allegis, seeking his understanding and support of our cause. That meeting was positive and communications will continue.

We also want to make it clear, Mr. Chairman, that we have no ties to any union or to management. We are not anti-company or anti-union. Many of the friends and supporters of CARE belong to the several unions representing United employees; many are non-contract people; and many are even management people.

I give you this background on CARE since we are a new group, and relatively unknown outside United, and we realize that you need to know who we are and represent. We very much appreciate this opportunity to appear before this distinguished committee, Mr. Chairman.

Let me say at the outset, sir, that we recognize that any legislation that might result from these important hearings will not, more than likely, help the United employee. We feel that events are moving too swiftly in the Allegis situation to help us with our problem. But we do feel that the concerns and fears of United employees at this time may be helpful to you in your deliberations, so that other employees of other companies who will follow us, facing the same threatening situation, will have the protection of any legislation that might come out of these hearings.

Allegis, as you know, has been under active "play" in the stock market in the last two months or so. The Coniston Partners, Jay Pritzker, perhaps Marriott and others, and the Airline Pilots Association union (ALPA). It was ALPA which began the process a few months ago with an offer to buy out United from Allegis for $4.5 billion. With the help of Wall Street advisors, ALPA informally made an offer to buy and operate United.

The ALPA proposal, which we understand has never been officially put on the table nor has the full details been made available to the public, would result -- as nearly as our financial advisors can determine -- in such a highly leveraged position for the company that it would seriously jeopardize its survival and the future of its employees. The debt would be staggering and harmful to all employees.

We are not here to attack ALPA. We use this illustration as but one example of how employees in a takeover can end up powerless and with no voice in their own future.

The ALPA buyout strategy, as we understand the facts, was conceived at the master executive council level, a committee of five who run the union. Their Wall Street advisors assisted in this effort. The plan was never submitted to the membership of ALPA. Nor was the plan discussed with the members of the machinists union or the flight attendants union, or with the non-contract employees.

The heart of the ALPA financing plan, which would enable them to take control of United, is an Employee Stock Ownership Plan (ESOP). Not one single employee was asked if he or she would be willing to be part of an ESOP, and accept the financial risk, of that takeover plan. We don't think that a system which permits the misuse of the ESOP, denying employees the right to vote on the proposition, is a fair and democratic one. We are not against ALPA or ESOP's per se, but against a permissive arrangement which permits a minority to use the ESOP as a device to impose their will on a majority.

The employees we speak for are realists. They understand that airline deregulation is here to stay, that it serves the consumer best. We understand the highly competitive nature of our industry, that costs must be driven down and productivity pushed up. They know that their pay and benefits are vulnerable in any takeover. We seek no legislative action that would impede the free market forces from reaching their efficient best.

We do think, however, that there are questions of basic democratic fairness in plans such as the ALPA proposal. Under their plan, and in order to service the enormous debt they would incur in the buyout, all employees wages would be cut by at least 25%, layoffs would result, pensions would be put at some risk, and pension payouts would perhaps amount to less than employees had planned.

We do think those planned paycuts and layoffs are an excessive response to an excessive debt load. But the issue of great concern to us, and the issue we believe is of concern to this committee, is one of pension rights and the use of an ESOP to take control of a company without due democratic process. That situation is much like the condemned being forced to buy the bullets for his own firing squad.

Permit us to suggest a few ideas, perhaps not new, which might help solve problems such as United employees now face. If you choose to more closely regulate ESOP's, consider the following:

1. Require an affirmative vote of ALL employees of a company before allowing an ESOP to be put into effect. This would be designed to prevent a minority of employees from initiating an ESOP, such as ALPA is attempting to do, which would offer special benefits to that minority while at the same time increasing the risk of job loss or the need for unreasonable wage and benefit concessions from all other employees who are the majority.

2. Amend the law to require the introduction of an ESOP over a period of several years. The original intent of the ESOP legislation, we are told, was to allow an employer contemplating retirement to pass ownership to his employees gradually without the debilitating tax consequences which would occur if an ESOP did not exist. If that's true, then the ESOP today may well become a tool working against the employees own interest.

These are only ideas, Mr. Chairman. We are not experts in law or politics. We operate airplanes for a living. We love our company and want to see it prosper and grow. We accept the realities of a deregulated marketplace. We only ask for a level and democratic playing field as we seek to do our work for an important part of the country's critical transportation system.

At the moment, we the employees of United Airlines, do not feel that the ESOP, as it would be applied to the proposed takeover of our company by ALPA and which would place our pensions in question, is either fair or level or in keeping with our democratic principles. We think that it is an issue not unlike the now accepted American ideal of "one man, one vote."

Thank you Mr. Chairman, and the entire committee, for your interest and attention.

The CHAIRMAN. Mr. Kaplan.

STATEMENT OF JARED KAPLAN, ESQ., KECK, MAHIN & CATE, CHICAGO, IL

Mr. KAPLAN. Thank you. My name is Jared Kaplan. I am a partner in the law firm of Keck, Mahin & Cate in Chicago, IL. I am also chairman of the ESOP Association's Legislative and Regulatory Advisory Committee, and I am a member of the State of Illinois Employee Owned Enterprise Advisory Council.

In addition, I have been privileged to work with Lee Bailey in the Eastern Airlines and United Airlines matters that he talked about. I have also been privileged to work with Mr. Barber in the Eastern Airlines matter.

A significant part of my law practice is devoted to employee ownership arrangements and corporate transactions involving employee ownership and employee owned companies.

NO SPECIAL RULES TO PROTECT EMPLOYEE OWNED COMPANY

Under present law, employee owned companies are treated no differently, for most purposes, from any other companies in the takeover process. There are virtually no special rules to protect the unique interests of employees in an employee owned company.

For example, an employee trust, an ESOP, holding a significant portion of the stock of a public company will be treated as just another stockholder, generally, in the takeover process. The point I want to make today is that some employee ownership programs, in certain cases, may facilitate an unwanted takeover or a takeover that is not in the employees' best interests. You have already heard in testimony—previous testimony this morning about the *Chicago Pneumatic* case, the *Danaher Corp.* v. *Chicago Pneumatic Tool Co.* case. That case is discussed in some detail in my written statement, but maybe I can boil it down to 2 key points that are of great concern.

The first point is that that case states, generally, that the trustee of an ESOP, in responding to a tender offer, isn't protected in relying upon the instructions that the trustee receives from the participants in the plan, who are the beneficial owners of the stock where the decision is whether to tender it.

Second, the language of the decision suggests that a trustee in deciding whether or not to accept a tender offer is really required to ignore the interests of the participants in the plan as employees.

Now although it is not clear whether other courts will follow those principles of the *Chicago Pneumatic* case, the opinion does suggest that a partially employee owned company may be more vulnerable to an unfriendly takeover than a company without employee ownership. The trustee may be faced with having to override the express wishes of the employee beneficiaries of the trust and to ignore the fact that their jobs will be threatened if the takeover attempt is successful.

This is a particularly anomalous result, because, in many cases, it would be the opposite result that would obtain, if the employees owned the stock directly in their own names rather than through an employee stock ownership trust.

The CHAIRMAN. Let me just interrupt to ask. Does the provision in our bill, S. 1323, that provides for respect for State corporate governance, meet the objective.

Mr. KAPLAN. Well I support the intent and the purpose of the provision in the bill. I think that it doesn't fully cover the point, because I think the point really is that here you have employees who, if they owned the stock directly, could decide whether or not to tender.

The same rule ought to apply, the same approach ought to apply, if the shares are held in trust for them by a trustee, and they are merely the beneficial instead of the record owner.

I think a more direct rule and a more constructive rule, in many cases, would be simply to pass through the decision on whether or not to accept a tender offer to the participants in the plan who are the beneficial owners of the stock. I think that would get you around what I view to be some technical problems in applying ERISA standards that are different from current ERISA standards and some of the other problems that I see in that provision of the bill.

A second reason, aside from the *Chicago Pneumatic* case, that employee ownership may really facilitate an unwanted takeover, is illustrated by a case that has to do with the Eastern Airlines situation, *IAM Stock Ownership Investment Fund* v. *Eastern Airlines.*

In that case, the court said that the company didn't have to come up with the funds to permit a trustee to challenge an unwanted takeover, and again, where a company has committed itself to employee ownership, I think a sensible approach would dictate that the company should follow through on that commitment, providing funds for a dialog to occur, instead of invading retirement money for that kind of a dialog.

The fact that employee ownership programs enhance productivity, reduce turnover and foster capital formation has been documented. And you asked earlier, Mr. Chairman, about evidence of that. In my written testimony, there is a reference to the book "Employee Ownership in America," Rosen, Klein & Young. And there are other studies that are available and that I would be happy to furnish to your staff to document that assertion.

Employees who obtain ownership in their employer through an employee stock ownership program have a qualitatively different investment in the company from other stockholders. In addition to money, they have invested their livelihoods and their careers in the company. Frequently, they have been willing to take lower wages or endure more difficult working conditions, in order to obtain a measure of ownership. It has been statistically demonstrated, as I said, that employees in employee-owned companies work hard and work more productively than those in other companies.

NONEMPLOYEE STOCKHOLDERS WELCOME TAKEOVERS

Employees who have made this level of commitment ought not be exposed to the risk of takeover to the same extent as employees in other companies. Often nonemployee stockholders welcome a takeover, because all they have invested is money, and the takeover means a profit.

The employees in an employee-owned company have much more invested than merely money, and a takeover, to them, may mean unemployment or disruption of their careers.

The current state of the law in this connection is unsatisfactory, as I have said. There is a rule in the general law governing ESOP's that requires a decision on a merger of the employer company with another company to be passed through, with a vote to be passed through directly to the participants.

But there are serious loopholes in this requirement under current law. First, that rule applies only to shares that have already been allocated to employee accounts. Often, as in the *Chicago Pneumatic* case, there will be a significant portion of the shares held by the trustee that are not yet allocated.

Second, if the takeover attempt is in the form of a tender offer rather than a merger, then an opposite rule applies. Under the *Chicago Pneumatic* case, the trustee may not be—may not even be able, even if the plan provides, to pass through the decision to the participant.

This seems to run counter to the congressional policy underlying the pass through voting requirement for mergers and consolidations.

In my written statement, I talk about the Eastern Airlines situation, which I think has been really pretty well covered by Lee Bailey, but I think it does illustrate that the absence of adequate protection for the employees' interests in that Eastern-Texas Air case, that resulted in a loss to investors as well as serious damage to the employees.

In view of these considerations, I believe there are at least 2 areas where specific legislative action would be helpful. First, portions of the *Chicago Pneumatic* opinion should be overridden by legislation. Employees should be given the right to vote on a proposed takeover. Specifically, the law should make it clear that a trustee may seek and rely upon the direction of participants in an employee stock ownership plan as to whether shares allocated to their accounts should be exchanged or tendered. It should also be made clear that the trustee may vote, exchange or tender unallocated shares in proportion to the way that the participants have directed that the allocated shares be voted, exchanged or tendered.

The law should also make it clear that the trustee may consider all of the interests of the participants, including their interests in protecting their jobs and conditions of employment.

Second, I would endorse the idea that has already been advanced here this morning, that the law should provide for a right of first refusal, permitting employees to match any offer, where a company's employees own a significant portion of the company's stock, particularly where those shares were received in exchange for wage concessions.

Thank you very much.

[The complete prepared statement of Jared Kaplan follows:]

STATEMENT
OF MR. JARED KAPLAN
BEFORE THE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
June 26, 1987

Mr. Chairman and Members of the Committee, my name is Jared Kaplan. I am a partner in the law firm of Keck, Mahin & Cate, in Chicago, Illinois. I am also Chairman of the ESOP Association's Legislative and Regulatory Advisory Committee, and a member of the State of Illinois Employee Owned Enterprise Advisory Council. A significant part of my law practice is devoted to employee ownership arrangements and corporate transactions involving employee ownership programs and employee owned companies.

Under present law, employee owned companies are treated no differently for most purposes from any other companies in the takeover process. There are no special rules to protect the unique interests of employees in an employee owned company. For example, an employee trust holding a significant portion of the stock of a publicly owned company will be treated as just another stockholder in the takeover process. In fact, some employee ownership programs in certain cases may facilitate an unwanted takeover or a takeover which is not in the employees' interest.

One way in which partial employee ownership may increase the vulnerability of a company to an unwanted takeover is illustrated by the opinion of Judge Laval of the United States District Court for the Southern District of New York in Danaher Corp. v. Chicago Pneumatic Tool Co., 7 EBC 1616 (May 13, 1986). That opinion suggests that the trustee of an employee stock ownership plan may be required to ignore the directions of the employees and their interests in preserving their employment in a hostile tender offer situation. In that case, a public company was approximately 20% employee owned through an employee stock ownership plan (ESOP). The Court indicated that an independent, neutral trustee would have to respond to the tender offer, and that in doing so the trustee would not be permitted automatically to follow instructions from the employees who were the beneficiaries of the employee trust. The Court further suggested that the trustee might have to ignore the interests of the current employees in protecting their job security, being guided instead by the goal of preserving strictly the financial interests and future retirement benefits both for the existing group of employees and future employees.

Although it is not clear whether other courts will follow the principles articulated in the Chicago Pneumatic case, that opinion suggests that a partially employee owned company may be

more vulnerable to an unfriendly takeover than a company without employee ownership. A trustee may be faced with having to override the express wishes of the employee-beneficiaries of the trust and to ignore the fact that their jobs will be threatened if the takeover attempt is successful. This would certainly be an anomalous result, since it would be the opposite outcome from that which would obtain if the employees owned their stock directly instead of beneficially through an employee trust.

A second reason that employee ownership may facilitate an unwanted takeover is that the trustee holding stock for the benefit of employees may be unable to obtain the necessary funds to resist an unwanted takeover. The case of IAM Stock Ownership Investment Fund v. Eastern Air Lines, Inc., 7 EBC 1937 (District Court of Delaware, July 3, 1986) illustrates the difficulties which an employee ownership program may encounter in seeking to obtain legal and financial advice to respond to an unwanted acquisition. In that case, the Court refused to order the employer to provide funding for the expenses of engaging advisors to the employee ownership trust which would have enabled the trustee to challenge the proposed acquisition of Eastern Air Lines, Inc. by Texas Air Corporation. The trustee was therefore faced with the prospect of using funds which were earmarked for employee benefits for the purpose of obtaining such independent advice.

The fact that employee ownership programs enhance productivity, reduce turnover and foster capital formation has been documented. See, e.g., Employee Ownership in America, Rosen, Klein and Young (Lexington Books, 1985). Certainly, Congress has embraced a policy of encouraging employee ownership programs through granting substantial tax and other benefits. Insufficient attention has been given, however, to the vulnerability and potential misuse of these programs in a takeover context.

In most cases, an employee ownership program can be established by action of the board of directors of a company without stockholder approval and without participation in that decision by employees. Even in situations where stockholder approval is required or sought, it is generally not necessary to obtain the consent of employees for the establishment of an employee ownership program. An exception is the situation in which the benefit structure is a matter of collective bargaining. Often the employer seeks wage or other concessions from the employees in exchange for the establishment of an employee ownership program. In such a case, the employees are involved in the decision-making through the normal collective bargaining process.

Employees who obtain ownership in their employer through an employee ownership program have a qualitatively different investment in the company from other stockholders. In addition to money, they have invested their livelihoods and their careers in the company. Frequently they have been willing to take lower wages or endure more difficult working conditions in order to obtain a measure of ownership. It has been statistically demonstrated that employees in employee owned companies work harder and more productively than those in other companies. Employees who have made this level of commitment should not be exposed to the risk of takeover to the same extent as employees in other companies. Often non-employee stockholders welcome a takeover because all they have invested is money and the takeover means a profit. The employees have much more invested than merely money, and a takeover to them may mean unemployment and disruption of their careers.

The current state of the law in this connection is unsatisfactory. The rules governing employee stock ownership plans (ESOPs) require that the participants in the plan be given the right to direct the trustee on how to vote shares allocated to their accounts in the case of a proposed merger or consolidation. However, there are serious loopholes in this requirement. First, the rule I have just described applies only to shares allocated to employee accounts. Often, as in the Chicago Pneumatic case, a significant portion of the shares held by the trustee will be unallocated, that is, not yet placed in participants' accounts, and therefore not subject to the voting passthrough requirement. Secondly, if the takeover attempt is in the form of a tender offer rather than a merger, there is no requirement for a passthrough to participants of the decision as to whether the shares held in trust are to be tendered. The Chicago Pneumatic case, as previously noted, suggests that the participants are to be deprived of the ability to direct the trustee's action on a tender offer, even if the plan permits such a pass through. Under the Chicago Pneumatic case, even if the trustee were to receive employee direction not to tender, a trustee might be required to override that direction if he concluded that the employee direction was motivated more by the desire of the employees to retain their jobs than by concern over the longterm retirement interests of current and future participants in the plan. This seems to run counter to the congressional policy underlying the passthrough voting requirement for mergers and consolidations.

The recent acquisition of Eastern Air Lines, Inc. by Texas Air Corporation is a compelling example of a situation where the legitimate interests of employees were defeated in a corporate acquisition of a company with a significant employee ownership program. In the Eastern case, employees bargained for roughly a 25% interest in the company in exchange for significant wage concessions. Thereafter, without consulting the employees, who had themselves expressed an interest in acquiring the company, the Board of Directors entered into an agreement to sell the company to Texas Air Corporation. The employees were in a position to have acquired the company through an employee ownership program of their own, which would have produced a better price for Eastern's stockholders, while at the same time protecting the employees' job security and working conditions. Although the matter is still in litigation, at least for the moment the absence of adequate protections for the employees' interests have resulted in a loss to investors as well as serious damage to the employees.

In view of the foregoing considerations, I believe there are at least two areas where specific legislative action would be helpful:

1. Portions of the Chicago Pneumatic opinion should be overridden by legislation. Employees should be given the right to vote on a proposed takeover, whether it is in the form of a merger, tender offer, or other arrangement. Specifically, the law should make it clear that a trustee may seek and rely upon the direction of participants in an employee stock ownership plan as to whether shares allocated to their accounts should be exchanged or tendered. It should also be made clear that the trustee may (in the absence of coercion, duress or fraud) vote, exchange or tender unallocated shares in proportion to the way that participants have directed that the allocated shares be voted, exchanged or tendered. The law should also provide that the trustee may consider all of the interests of the participants, including their interests in protecting their jobs and conditions of employment. The ruling in the Chicago Pneumatic case requiring the appointment of a neutral trustee where the original trustee had a conflict of interest appears consistent with the legislative framework and the employees' best interests.

2. The law should provide for a right of first refusal, permitting employees to match any offer, where a company's employees own a significant portion of the company's stock, particularly where the shares were received in exchange for wage or other concessions. Once again, Congress has encouraged the use of employee stock ownership programs by granting significant tax and other benefits, but this stimulus to employee ownership becomes academic if companies can be sold

> without giving employees the opportunity to utilize these benefits. In many cases, such as the Eastern Air Lines situation, the employees are able to pay a higher price than anyone else by utilizing the special benefits available to employee ownership programs. In order for these benefits to be brought into play, giving full effect to congressional intent, the employees must be given the right to propose an equivalent or better offer to the stockholders where a sale of the entire company is proposed.

Employee ownership has registered impressive advances over the last decade, and seems destined to continue to thrive. Congress has made a number of changes in the tax and labor laws to encourage and accommodate employee ownership, but the corporate law rules have attracted insufficient attention. I applaud the efforts of this Committee in addressing the unique interests of employee-owners in the takeover context, and appreciate this opportunity to express my views.

I will be happy to answer questions.

The CHAIRMAN. Thank you, Mr. Kaplan. Again, I want to thank you folks. Mr. Barber, are ESOP's negotiated by management bargaining with itself?

Mr. BARBER. Your question is basically, whether or not, in all instances employers maximize their benefits and minimize the benefits of participants.

The answer to that is clearly, no. You had a witness this morning, Lowes Co., where they voluntarily did more than that. I would say, however, that the norm is almost certainly that employers comply with the minimum standards of the law with respect to such things as pass through voting rights, distributions, vesting schedules, and so forth. And that in very few instances that I am aware of, have employers voluntarily permitted employees, for instance, to select a trustee, who often, really has the power to vote the bulk of the stock in those plans. The only instance I am personally aware of, is where they have been collectively negotiated and where the employer and a union have agreed to a process which allows for some form of direct employee input into the selection of the trustees.

Typically, I think, in legislation you worry about the companies that are acting at the minimum level of the law and to see whether or not that should be risen as opposed to whether or not there are some companies out there doing better, which clearly, there are.

COMPANIES ARE PERMITTED TO DESIGN AN ESOP

The CHAIRMAN. Now at the bottom of page 2, you say, and I quote, "Closely held companies are permitted to design an ESOP in such a way that participants will never be able to vote for the board of directors or cast votes in any other shareholder issue not explicitly defined as major by the Tax Code."

Mr. BARBER. That's correct.

The CHAIRMAN. How common is that?

Mr. BARBER. How what?

The CHAIRMAN. How common is that practice? Is it the usual practice

Mr. BARBER. I would say 80, 85 percent, at least, of privately held companies that have established ESOP's are there—and I think that is conservative.

The CHAIRMAN. So you are telling us, then, that in your view, as far as any effective ownership, any decision is concerned, ESOP's a sham.

Mr. BARBER. May I say that the "ESOP industry," which I refer to, which has some very talented people in it, and some people who clearly see that there is a way to generate more business, much of the literature that you can find out there advertising ESOP services talk about how employers or owners of closely held companies can sell a company to the employees, gain a friendly buyer and maintain control of the company at the same time. It is very clear that it is possible to maintain control within the hands of management, even in a 100-percent employee-owned ESOP in a privately held firm.

The CHAIRMAN. Mr. Kaplan, do you agree with that?

Mr. KAPLAN. I don't really agree with all of the implications, although Mr. Barber has accurately, I think, described the law as it applies to privately held, closely held companies.

I want to emphasize, though, in the context of this committee's inquiry, that for a public company, the kind of company that would typically be subject to a takeover, full pass-through voting is required on all allocated shares in an ESOP. So that I think Mr. Barber was talking only about the rules applicable to privately held companies that don't have any registration type securities.

The CHAIRMAN. And you think that the publicly held companies would have a large number of employees, by and large?

Mr. KAPLAN. Well, there are a couple—first of all, I think they have a larger number of employees, and those are the ones that are generally subject to takeovers.

In the case of the privately held company, the closely held company, I believe that the voting right arrangements that Mr. Barber has accurately described, were an attempt by Congress to walk a tightrope, to give the employees as full a range of rights as would be appropriate in a company that is not a publicly held company, that doesn't have to answer to any other outside stockholders, and at the same time, to make ESOP's attractive to the managements of those otherwise privately held companies.

So, although I think Mr. Barber has accurately described the rules, I guess I disagree with the implication that that is an unhealthy situation. I think that the existing rules have worked well, and I am not aware of widespread abuses of those arrangements.

The CHAIRMAN. Mr. Barber wants to respond to that.

Mr. BARBER. First of all, I was not making a statement with respect to whether or not in the situations where you have a privately held firm that management has abused things one way or the other. I happen to believe that that is probably the case in a number of instances, but I was describing a fact.

Mr. Kaplan is correct that publicly held firms, you have to pass through the voting rights; however, I believe one of the real trends that's going on today, are where publicly held firms are either taking themselves private or spinning off part of their assets and going private.

As I understand it, the Hospital Corporation of America's proposed ESOP spin-off would, in fact, only pass through voting rights on majority issues, which means that by definition, they will not be passed through for board of directors, and so forth.

The CHAIRMAN. Mr. Kaplan, I have a lot of sympathy for your argument that, whereas the stockholder only has money involved, the employer has his life and his career involved. That appeals to all of us. But it seems to me, it is very hard to translate that into anything meaningful. The stockholder holds the business. He owns the business. On the basis of all experience, all practice, in the capitalistic system, the owner is the boss. And as the owner, he can sell the business, liquidate the business, do anything he wants to with the business. And he owes absolutely nothing to the employee, unless the employee has a union of some kind.

So it seems to me that under those circumstances, the only way that the employee can get power is to become a stockholder, and then the only power he can exert as a stockholder is the vote. Are you implying that there should be some special additional power that an employee who is a shareholder should have?

Mr. **Kaplan.** I made the argument that employees who are part owners of a company have an unique interest. I made that in support of my legislative suggestion that the employee be given a right of first refusal to match any offer that comes from a nonstockholder, outside third party. And I agree with you that employee stockholders ought not to be given any preference, but——

The **Chairman.** You give them a preference on the first refusal.

WAGE CONCESSIONS DO NOT GUARANTEE EMPLOYEES JOBS

Mr. **Kaplan.** I raise the point only in this sense, that where the employees have given something up, for example, where wage reductions have been negotiated through the collective bargaining process in exchange for employee ownership and where the employees are not asking for anything that would give them any preferential rights over any other stockholders, that there ought not be a situation as you had in Eastern Airlines, where the company comes to the employees and says, if you give me a part of your pay, I will give you a part of the ownership of the company. And the company management then goes behind the back of those same employees and makes a secret deal to sell the company to somebody who will take away everything that those employees thought they were bargaining for.

In that case, I think there is a qualitatively different status of those employees, and they shouldn't—I agree with you. They shouldn't be put ahead of anybody, but what they should be given is the right to know and the right to make an offer of their own to the stockholders of the company to see if they can come up with something that is as good or better than the third party is willing to come up.

The **Chairman.** Mr. Palmer, we have seen cases where employees attempt to take over airlines. In the United case, though, these are pilots. Men and women who are paid 6 figure salaries and make more than Senators—are probably more valuable than Senators. Some call the Air Line Pilots Association a "tuxedo union."

Is an employee buyout really a practicality for most other companies where there isn't such a gilded class of employment? Isn't it true that for the overwhelming majority of people, their savings are so relatively small that they can't participate as the effective stockholders the way you can in the United case?

Captain **Palmer.** I would say that that appears to be the case, yes. What we have at United is, as you referred to, we have a case of a very small minority that wields a very large axe, imposing its will on the vast majority of employees without ever consulting them.

I think that what we have—what we are talking about here this morning, in a large case, is what happens when an ESOP is in effect, how it is to be sustained and looked over, so that it is not misused. But I would submit to you that I think that we must examine before an ESOP ever goes into effect whether or not the employees should have, as a whole, a say in their features, whether they want an ESOP or not. And at United Airlines that is not the case.

Like I say, if you took a vote on United Airlines today, the overwhelming majority of employees would vote no for an ESOP.

The CHAIRMAN. Let me ask you this. Some observers of the Eastern Airlines case suggest a lack of coordination between the unions led to the merger with Texas Air. While you may criticize the ALPA proposal as less than optimum, do you think that maybe you might deliver Allegis into the hands of a manager that would be less capable than either present management?

Captain PALMER. I think that that is always a possibility. I would think and hope that the unions, on any property, would get together before the fact and come to some sort of an agreement or agreement that was in the best interests of all the employments, all the unions, and then make some suggestions and have some say in what the future management of that corporation was going to be.

I think that is an important fact of any ESOP. I think that everybody has to have a say in, you know, who the management is going to be.

The CHAIRMAN. Mr. Kaplan, you have spoken on giving employees a right to match an offer by a raider, the right of first refusal.

Can you tell me exactly how that would work. Would you require that employees already control a certain minimum of shares? Would there be a time limit?

Mr. KAPLAN. Yes. I think that certainly, a right of first refusal ought to apply only where there is specific concentration. A significant ownership in an employer stock ownership program. I think another relevant factor might be to ask what, if anything, have the employees given in exchange for the stock ownership? Certainly, the strongest case for the right of first refusal would be the Eastern Airlines type situation, where the employees have been asked by the company to give up wages, to give something and to put in their own money in exchange for an ownership interest in the company.

So I think that not only would concentration of ownership, a minimum percentage of ownership of a company be relevant, but I think one might also ask how the shares were acquired and whether anything was given in exchange.

I want to thank all of you witnesses for excellent testimony. It has been very, very helpful. You have certainly helped us improve our record, and I think we can improve our legislation.

The committee will stand adjourned.

[Whereupon, at 1:00 p.m., the hearing was adjourned.]

[Additional material received for the record follows:]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

REMARKS OF CAPTAIN F. DUBINSKY, CHAIRMAN UNITED PILOTS' MASTER EXECUTIVE COUNCIL AIR LINE PILOTS ASSOCIATION

Before the Senate Banking Committee
July 17, 1987

Mr. Chairman and distinguished members of the Senate Banking Committee on behalf of the pilots of United Airlines, I would like to thank you for the opportunity to submit remarks for the record concerning the United pilots' plan to purchase United Airlines from the Allegis Corporation. My name is Captain F. C. Dubinsky and I am the Chairman of the United Pilots Master Executive Council of the Air Line Pilots Association, and ALPA is the certified bargaining agent for the pilots on United Airlines.

On June 26th the Committee heard a statement from a Mr. William Palmer who is a director of an organization that calls itself CARE. Mr. Palmer's statement, in large part, discussed ALPA's plan for the United employees to purchase United Airlines and use an ESOP to make the financing possible. Mr. Palmer's statements were so grossly inaccurate that I appreciate the opportunity to set the record straight.

Mr. Palmer claims to represent thousands of United employees and yet all three unions on United's property have taken public positions strongly opposed to CARE's activities. In fact, at CARE's four meetings, their audience has been less than two thousand and many in attendance left upset that CARE's primary message was merely anti-ALPA, rhetoric, and attention to the facts was negligible. It should be noted for the record that Mr. Palmer, while stating that he is not anti-union is currently involved in a lawsuit against ALPA, has worked, with management's help, to form an upstart pilots' union at United, and crossed the pilots' picket line in 1985 during a strike in which 96% of the United pilots withdrew their services. Mr. Palmer has worked tirelessly against ALPA for several years and in his lawsuit against ALPA was so loose with facts and promises in his solicitations that he was severely chastised by a Federal District Judge.

The CARE organization originally called itself the Coalition Against Raiders and ESOP's, until United management announced that it was cosidering implementation of an ESOP to ward off hostile takeover attempts. Mr. Palmer immediately changed the name of his group to the Coalition Acting for Rights of Employees so that he might further assist managment.

Mr. Palmer states that there are many employees at United and on that we agree. All of us saw that our corporation, with its under-utilized mismanaged assets, was a definite takeover target. Unlike Mr. Palmer, who with his gross misstatements merely fanned the flames of fear, the ALPA leadership decided to embark on a course designed to protect the interests of all United employees by giving them a strong voice in their futures through employee ownership.

By way of background, let me say that I am a United pilot. Along with two other officers, I have been working full time for the pilots' union, ALPA. We were elected by the 27 local representatives of the pilots, the MEC. They were elected directly by their local pilots. Our term of office began in December of 1986, and the 27 local representatives gave us a strong mandate: explore ways to stop current management from using monies generated by our work at the airline to diversify into other non-airline businesses. In short, the pilots wanted the results of our labors reinvested in the airline.

Almost immediately, I began to explore a wide variety of possibilities. In a very short amount of time, it became clear that employee ownership was one of our best options. The three MEC Officers decided to explore this option fully. We hired the best legal and financial advisors in this country and indeed duplicated disciplines to insure a free flow of information and opinion. From the beginning it was made clear to all our advisors that the plan, if the three MEC Officers decided to go with it, would first have to be accepted by a clear majority of the pilots. Frankly, without the participation of the clear majority of the pilots, there was a small question as to how these advisors were going to be paid. Fortunately, from the beginning, our plan contemplated majority ownership by all United employees, an if successful, this would be the largest transaction of its type in history. This proved to be quite an incentive to all involved, and we proceeded. As our plan developed a troublesome possibility became a reality, a raider, Donald Trump, started to "take a position" in Allegis stock. If Mr. Trump's actions caused Allegis to become "in play" all employees would have been faced with being on the sidelines as outside forces put their careers and futures in doubt. Too often in hostile takeovers the only group with no voie is the group most adversely affected by the takeover, the employees. We decided to push our plan forward as the best way to protect the interest of United employees at that time.

In April, along with our legal and financial adivsors, the three MEC Officers presented the plan to the 27 local pilot representatives for their decision. After a two day presentation the local representatives voted unanimously to propose a $4.5 billion purchase of United Airlines. This plan was still contingent on the majority of pilots backing the plan.

Two days later we held a nationwide teleconference to explain the plan. All employees were invited to attend. At the end of the teleconference the pilots were told if they wanted to support the purchase plan and the ESOP, that a voluntary 5% donation of their gross annual pay would be required to pay fees and other costs to keep the plan alive. In less than two weeks, well over $13 million in voluntary support was mailed in from the vast majority of our memberhsip. The pilot has indeed been given a chance to voice their opinion of our plan, and they have chosen to support it enthusiastically.

I want to make it clear that our proposal contemplates employee ownership by all United employees. To that end, prior to our plan being developed we contacted the leadership of the flight attendants and machinist unions to see if they wanted to be involved in the initial phases of the planning. While they declined to actively participate, they were constantly updated as to our progress. Both unions have finanial advisors of the highest quality and we remain in constant contact.

As to the non-contract workers, clearly this group of employees as a whole has never had any say as to the direction of the corporation. The group is very diverse, ranging from the highest paid management executive to low hourly wage workers. Except for the highest level managers, this group has never had any representation or voice. The pilots' purchase plan contemplates changing that significantly. First, a trustee will be appointed to represent the interests of the non-contract employees throughout this process. Secondly, through the ESOP, non-contract employees will be able to voice their opinions by voting their stock. They wiil for the first time have a true say in their futures. Further, realizing that most non-contract workers earn less than pilots, the plan calls for less wage impact for their group. While high end managers will contribute 25% of pay as will all pilots, the lower end wage earner will contribute wage give ups of much less, perhaps as low as zero, so that on average the non-contract group will contribute a total of 15%, and less than the pilots' 25% cuts. Remember, too, that stock will be issued in return for these wage adjustments. For the first time, these employees will no longer be disenfranchised by their non-contract status. They will have the power of ownership to back up their hard work. In our plan, we have never contemplated such draconian measures as layoffs by the thousands, a path which management is currently on. The non-contract employees have no voice as they are being erased from the corporate rolls. Our plan contemplates no such layoffs or cuts.

The two other unions on the property will have the option of participating in the ESOP or not. That will be their decision and will be part of discussions between this union and the pilot's union prior to the purchase or, perhaps, part of the collective bargaining process between them and new management after the purchase. Management which, by the way, will not be made up of pilots, rather there will be highly qualified managers hired by a new independent Board of Directors. Managers will work for the Board and to the benefit of the shareholders who will be the employees. Also, it should be noted here that we expect very few changes in management. Most United managers built United into a first class airline before. Given the chance, we expect that with new direction they will once again make United great.

Again, at the heart of our plan we hope that all employees both union and non-union will actively participate in the ESOP. When that happens, we all can work towards a common goal of a dominant United Airlines and an employee group with secure futures.

Mr. Palmer's testimony made another vague assertion that pensions may be somehow placed in some question. Obviously, pension security is of great concern to all of us. To protect our pensions our plan calls for annuities to be purchased to protect all pilots from any possible loss of pension benefits earned to date. These annuities clearly afford more security than the present pension trusts.

Dues to membership input our pension protection plan was further developed to afford even more protection for our members. I have included details of our plan's description for your review.

CARE asserts that our proposal has never been officially put on the table. Judging by the exchange of letters, meetings between corporate and union officers, and investment advisors, I think management and Wall Street feel that the proposal is official and very real, even if Mr. Palmer and his advisors have missed that reality.

Mr. Palmer and his group hired an accounting firm from Denver to "evaluate" our financing plan. Suffice it to say that two of the most prestigious investment banking firms on Wall Street, Lazard Freres and Solomon Brothers, developed our financing package. They analyzed all public financial data available about United Airlines and put the plan together. Both firms agree that our plan is fair, financeable, and do-able, and that there are monies available to pay back our purchase debt, buy aircraft to expand and remain a force in the airline industry. Investment houses all over Wall Street agreed that we could be successful as they reviewed our plan and purchased our stock. Our plan can work. In fact, the new management at Allegis is "borrowing" many of our plan's ideas except that they desire to remain in control and offer the employees more layoffs and pay cuts with nothing in return. What voice do the non-contract employees have now as management works feverisly to entrench themselves at the expense of thousands of jobs?

Again, the pilots plan is one that can work for everyone, the shareholder, the employees, and the corporation alike. It addresses the realities of the "market" and the market place while attempting to benefit all the employees. After all, the pilots are employees of the United Airlines also. In our plan, we have offered the largest amount of wage cuts and productivity increase not only to make United Airlines more competitive, but to make it survive in the hands of those who built it and love it the most, its employees.

I have included, for the record, copies of all the ESOP information that we have distributed to our pilots and other employees we contact. The Association of Flight Attendants has mailed this information to its members and has recently stated in the press that it will give this management and its restructuring plan no labor concessions unless they are in return for employee ownership. We also have an 800 phone number where all employees can get ESOP information: it is 1-800-322-ESOP, feel free to call.

I believe my remarks along with attachments will set the record straight about the United pilots plan for an all employee owned airline. These are difficult times for many industries and employees groups throughout the United States. Faced with economic realities, we have embarked on a path which, hopefully, will lead to a more secure future for our United employees family. We believe that when the truth about our proposal comes out that it is obvious that what we have done is develop a management financial tool and use it to protect what we have built.

Mr. Chairman and members of the Committee, again thank you for the opportunity to set the record straight about our proposal. After all, opportunity is what has made this country great, and if some wonder what we hope to accomplish, I guess I might sum up by saying that we are workers who have decided to join together to become a good old fashioned Capitalists.

Thank you.

ASSOCIATION OF FLIGHT ATTENDANTS AFL-CIO
1625 MASSACHUSETTS AVENUE, N.W. WASHINGTON, D.C. 20036 202-328-5400

June 26, 1987

The Honorable William Proxmire
Chairman
Committee on Banking, Housing and
  Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

We understand that Ms. Deborah Palm-Eagle may appear before the Committee today to testify with Mr. William Palmer.

Her testimony is neither endorsed by nor is in any way representative of the views or opinions of the Association of Flight Attendants, AFL-CIO.

Ms. Palm-Eagle is a Denver-based flight attendant employed by United Airlines and is not now and has never been either an elected or an appointed representative of the Association of Flight Attendants.

Sincerely,

Juliette D. Lenoir

Juliette Lenoir
Vice President

Statement of

Victoria Frankovich, President
Independent Federation of Flight Attendants

In Support of

TENDER OFFER DISCLOSURE AND FAIRNESS ACT

Before the

Committee on Banking, Housing and Urban Affairs
United States Senate

July 10, 1987

TENDER OFFER DISCLOSURE AND FAIRNESS ACT

Victoria Frankovich, President
Independent Federation of Flight Attendants

In the summer of 1985 Trans World Airlines, Inc. was "put into play" as a stock takeover target of corporate raider Carl Icahn. The ownership, and therefore the future of the airline and its 29,000 employees, was suddenly at great risk.

We, the employees of TWA, adopted a whole new vocabulary that summer: "investment bankers," "leveraged buyout," "tender offer," "greenmail," "white knights," "poison pills," "shark repellent" and "golden parachutes." When the trauma began TWA rallied the employees warning against the devastation we were facing at the hands of the heartless profiteer, Carl Icahn.

In less than a month TWA had selected a "white knight" to save us from doom. The "savior" was none other than infamous union busting Frank Lorenzo, fresh from Continental Airlines where he abrogated his union contracts using the guise of bankruptcy.

In the battle of the raiders, it was clear that regardless of the victor, TWA would have a new owner. It was also clear that whoever prevailed intended to demand substantial employee concessions to pay for the debt servicing, legal fees, greenmail and other takeover costs.

When the dust settled, Frank Lorenzo walked away with over $40 million in "greenmail"; TWA paid a reported additional $20 million in legal fees, advertising and other takeover battle costs; and the airline was saddled with millions of dollars in new debt financing. Two different investment bankers, Brian Freeman and Lazard Freres, each reportedly received $1.25 million for their respective roles in putting together the deals. An untold amount also went to Drexel Burnham.

Ultimately, Carl Icahn extracted more than an estimated $320 million from TWA employees in concessions to cover these costs. This wasn't enough. Mr. Icahn needed immediate capital to finance his raiding habits. Within a few months after assuming control, he sold half of the airline's "PARS" reservation system to raise capital. He next sold 2,500 pieces of equipment to Marriott in an agreement requiring TWA payments to lease them back. In early 1986, he arranged for a merger with Ozark Airlines and thereby bought out the major competitor in TWA's St. Louis hub. This left a virtual monopoly controlling 85% of arrivals and departures for TWA at that airport in a result even opposed by this Administration's Justice Department, albeit in vain. He then took the newly acquired Ozark aircraft and sold them to Polaris Leasing to raise capital for financing the merger costs. TWA now pays Polaris to lease back most of these same aircraft.

Subsequent to the TWA takeover debacle, Mr. Icahn further engorged his raider appetite by using TWA monies to "make a run" on USX. Not only was this raid unsuccessful, but as a result TWA now owns huge blocs of USX stock paid for with TWA worker concessions.

From the beginning there has been widespread speculation that Carl Icahn did not intend to become an airline operator. Most of us believe that Mr. Icahn is simply biding his time trying to make this property look sufficiently appealing to persuade someone else to buy it. He reinforced this belief with his recent run on US Air, cited by newspaper reports and industry observers as a "Pac-Man"-like maneuver aimed at forcing US Air to make a defensive offer to take over TWA. The US Air Board of Directors failed to take the bait, however, and strenuously opposed the Icahn maneuvers. The proposed takeover, ultimately unsuccessful, resulted in yet additional burdens on the TWA workforce.

The legal fees and related cost for these thwarted takeover attempts are not disclosed in any TWA Stockholder Statement or Department of Transportation documentation. These are simply now part of the cost of doing business absorbed with other legal costs, lobbying costs and advertising costs. But is this the business of running an airline? Are these costs which employee concessions can legitimately be expected to pay for?

Should TWA become a cash cow to be milked to produce money to allow continuing raids of other businesses? The emphasis is now on the short term production of capital to feed the immediate needs to improve the look of the balance sheet and produce ready cash for playing the stock market.

While TWA employees have suffered substantial economic harm, how much money has Carl Icahn made? How much will he make when he unloads TWA? With hundreds of millions of dollars in employee concessions in place, the financial picture for the corporation on a short term basis may improve. In fact, however, these concessions will offset the rising costs of fuel, losses due to price discounting and management or marketing miscalculations, or judgment errors.

While the financial community runs around patting Carl Icahn/TWA on the back for "getting employee costs under control," what really has gone on at TWA? All employees have been forced to "alter their lifestyles" and "pull in their belts." The cost of labor has reportedly dropped by 21% from 1985 to 1987.

One group, the Flight Attendants, has suffered far more than the others. According to Department of Transportation reports for the first quarter ASM of 1987, TWA Flight Attendant labor costs have been reduced by 48.1% over the first quarter ASM of 1985. How and why did this happen? A preliminary note about what happened to other TWA employee groups provides the answer.

First, Mr. Icahn accepted an estimated $100-110 million from the TWA pilots represented by ALPA whose total cost of labor was $368 million and whose average salary was $90,000 a year, a cut of 26-30%. Next, he took from IAM employees (mechanics, ramp service, dining and commissary), whose total cost of labor was $440 million and whose average salary was $36,500, an estimated $49 million in concessions, or an 11% cut. He then imposed on the management and non-contract ranks a 14% salary cut with an assurance that non-contract employees would not be required to take more cuts than contract employees. Finally, when dealing with Flight Attendants, whose total cost of labor was $285 million, with an average salary of $35,000, he demanded a concession package that he publicly estimated was worth $110 million, a 40% cut.

The Flight Attendant workforce was 85% women, more than one-third of whom are over 40 years of age. Average service with TWA was 15 years. Carl Icahn brought an outmoded, stereotypical image of the Flight Attendant workforce into his negotiations with the Independent Federation of Flight Attendants. He demanded such a disproportionate share of concessions with the glib justification that "stewardesses are second incomes" and "the girls don't need the money." When he was advised that the Flight Attendants, like all other workers, worked because they needed the money, he replied that anyone who could not afford the cut "should have married a rich husband" or "should have married a pilot."

Asked why a janitor who was paid about the same as a Flight Attendant should be given a lesser pay cut with no change in hours or benefits, while the demand from the Flight Attendants was a 22% pay cut plus massive proposed work rule, insurance and retirement reduction burdens, Mr. Icahn responded that "a janitor is a breadwinner, he probably has a family at home to support. You girls are second incomes."

Up to the last day of Mr. Icahn's "negotiations," the $110 million Flight Attendant demand remained unchanged. On the last night, he made one move and that was to reduce the concession demand from $110 million to $100 million. No further compromise was forthcoming -- nor has any been made up to today, one and a half years later. These excessive and disproportionate demands led inevitably to a conflict and the workforce found itself left with no alternative but to strike on March 6, 1986 to oppose the unilateral implementation of these terms and the probable immediate loss of up to 2,500 jobs.

After 72 days the union ended the strike, when it became clear that the corporate goal was the wholesale replacement of the workforce. Today, one and a half years later, this dispute still rages in the courts. For more than one year 5,000 people have been refused to allow to return to the job. We still have no negotiated contract and the corporation has refused to negotiate with the union since November of 1986. Hundreds of people have lost their homes, many have confronted financial ruin, and most tragically of all, two Flight Attendants committed suicide over despondency over their dire economic plights.

Labor relations in the airline industry have certainly not all been a bed of roses since the pressures of deregulation have caused the carriers to demand greater and greater employee concessions. The story of the TWA Flight Attendants, however, speaks to a far greater problem. We are the victims of heartless corporate raider intrusion into a Railway Labor Act/collective bargaining scheme carefully crafted by Congress over the years to encourage acceptable labor-management relationships. Federal labor law requires good faith bargaining totally absent in this paticular case because of a corporate raider who considers himself above the law.

The TWA Flight Attendants may nonetheless prove that maxim to be wrong. We have now won two major appellate court decisions and are confident that we shall ultimately prevail on the merits of all our claims against TWA over time. One of our cases includes a back pay and benefit award which Carl Icahn has publicly estimated may cost the corporation upwards of $50 million with the back pay total incresing each month. We have a major bad faith bargaining trial in process which, if successful, will potentially cost the corporation hundreds of millions of dollars in back pay and benefits and probably result in numerous suits against TWA by the newly hired "replacement employees" brought in to break the strike who were repeatedly promised permanent job protection by Mr. Icahn. Had the proposed legislation been in effect, these results might well be avoided since the Icahn takeover would probably have never happened.

Justice is very long in coming, but when the TWA Flight Attendants prevail who will pay? Not Carl Icahn. Not the corporate raider whose actions here at TWA and elsewhere have devastated the lives of thousands upon thousands of employees. No, it is the TWA employees who will ultimately pay. Carl Icahn, with his massive estate in Bedford, New York is insulated. Carl Icahn will have his "golden parachute" just as the TWA corporate executives before him. He has already told the TWA employees that if the Flight Attendants win he will simply dismantle the airline. This threat serves the multiple purpose of continuing to isolate the Flight Attendant workforce from the remainder of the TWA employees and to remind us of a threat made to us during the negotiations that he would not hesitate to put the airline out of business if the employees refused to meet his financial demands.

So much for good faith attempts to reach agreements. But then again corporate raiders play by a different set of rules. Is he right?

IFFA wholeheartedly supports the proposed legislation and urges its immediate passage. While this will not remedy our situation, it may serve to remove the economic incentive for short term disgorging of corporate monies to fight raids by individuals clearly not interested in the long term welfare of a corporation or its employees.

We would respectfully suggest one modification of the proposed legislation, namely inclusion of an amendment which would make employee concession demands to finance hostile takeover debt by a successful raider an unfair labor practice. While too late to help us, this could serve to protect other innocent workers from becoming pawns in the cold-hearted chess game this legislation seeks to eliminate.

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June 22, 1987

Hand Delivery

The Honorable William Proxmire
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate
Room 534, Dirksen Office Building
Washington, D.C. 20510-6075

Attention: Mr. Bart Naylor

Re: ESOP Provisions of S. 1323 and 1324

Dear Senator Proxmire,

As an attorney representing a number of corporations whose stock is primarily or in large measure owned by employee stock ownership plans ("ESOPs"), I am writing in support of the ESOP-related provisions of S. 1323 and S. 1324, presently before your Committee, as important steps toward a more rational set of legal rules governing the conduct of ESOP trustees in tender offer situations. If enacted, I believe these provisions will enable ESOP trustees to deal with tender offers in a manner which will better serve the interests of employees and the economy in general.

When introducing S. 1323 on June 4, you enumerated the evils inherent in what you described as the recent takeover "mania." Two of those evils are particularly pertinent when considering the relationship between tender offers and ESOPs. They are: (i) the loss of jobs which frequently follows a takeover and (ii) the short-term focus which often characterizes institutional decision-making with respect to tender offers.

As you described so well, recent tender offers have often been highly leveraged and have involved the purchase of stock at prices well in excess of market. After a takeover succeeds, a greatly enhanced cash-flow is required from the corporation in order to service the large debt which was incurred to finance the inflated price. The fastest way of improving cash flow is by cutting expenses, often by firing a large portion of the work force. A drastic reduction in employment may not be in the long-run interest of the corporation, but the short-run need to service the acquisition indebtedness is so urgent as to overcome long-term considerations.

Rank-and-file employees who participate in an ESOP maintained by an acquisition target are often well aware of the possibility that an acquisiton may be followed by layoffs. When this is the case, they typically will not choose to realize a profit of a few hundred or a few thousand dollars with respect to the value of their ESOP account at the potential cost of their jobs and the possible economic devastation of their community. If such employees are permitted to decide for themselves whether the stock held by their ESOP should be tendered, they may well decide against sale of the stock, based upon a rational consideration of their overall economic interest.

If a corporate takeover effort is structured, not as a tender offer, but rather as a proposed merger or a proposed purchase of substantially all the corporate assets, present law expressly allows employees to decide for themselves how to respond. This is because these acquisition techniques require a formal vote of the stock of the target corporation, and section 409(e) of the Internal Revenue Code requires that such a vote be passed through to the employees. In fact, section 409(e)(5) allows the employee vote to govern unallocated shares held by the ESOP as well as shares already allocated to the various employees' individual accounts. Thus, in corporate vote situations, the employees rather than the trustee have the right to vote the stock held by the ESOP.

Oddly enough, the law with respect to tender offers is quite different, even though a tender offer is simply an alternate strategy for achieving the same economic result as would be achieved through a merger. Since a tender offer does not require a formal shareholder vote, the provisions of section 409(e) are literally inapplicable. There is no similar provision of law which expressly permits the trustee of an ESOP to pass through to the employees decision-making with respect to a tender offer. In fact, there has been substantial reluctance on the part of the Department of Labor, as well as some courts, to permit trustees who are faced with tender offers to pass decision-making through to the ESOP participants. The Department of Labor appears to view a pass through of decision-making to employees as an evasion of fiduciary responsibility by the ESOP trustee; the Department strongly favors retention of decision-making by the trustee in tender offer situations.

However, while generally requiring the trustee to make the decision with respect to a tender offer, the law in its present state is interpreted by many as forcing the trustee to wear blinders -- to ignore the very real and very rational economic factors which would be considered by the employees if they were allowed to make the decision. Specifically, decisions such as that of the U.S. District Court in Danaher Corp. v. Chicago Pneumatic Tool Co., 635 F. Supp. 246 (S.D.N.Y. 1986), have led many to believe that a trustee presented with an above-market tender offer cannot consider the possibility of lay-offs when deciding how to respond. Put another way, the trustee can only consider the interest of the ESOP participants as account-holders and not their entire interest as employees.

This uncertain and irrational state of the law only serves to reinforce the short-term perspective of many institutional trustees. An institutional trustee faced with an above-market tender offer will be reluctant to reject it because, if sued, the damages (i.e. the excess of the tender price over market price) will be certain and easily ascertainable. In contrast, if the offer is accepted, damages, even if really far greater, would be speculative and difficult to prove. Hence, an institutional trustee has strong incentives to accept any tender which offers a price in excess of market without regard to the consequences of a successful tender to the long-term future of the corporation or its employees.

It is my view that the law should expressly permit ESOP trustees to pass through to employees decision-making with respect to tender offers. So long as the flow of accurate information to employees regarding the pros and cons of a tender offer is ensured, a rule that tender decisions, like merger decisions, be made by majority vote would be most consistent with the purpose of the Congress in permitting the establishment of ESOPs in the first place -- namely the desire to give workers a stake in the enterprise for which they are working.

However, so long as the decision with respect to a tender offer remains with the trustee, the ESOP provisions of section 10 of S. 1323 and section 16 of S. 1324 are important improvements in the law. I believe and hope that these sections will provide trustees with the flexibility to give proper weight to the long-run interests of ESOP participants, both as shareholders and as employees, when considering how to respond to a tender offer. I respectfully commend these provisions to the Committee, and I appreciate your efforts in introducing S. 1323.

Respectfully,

Daniel M Davidson

Daniel M. Davidson

DMD:lb

NEWS FROM:
Congressman
Larry Smith

Representing the 16th District of Florida
Portions of Broward and Dade Counties

STATEMENT OF REPRESENTATIVE LAWRENCE J. SMITH (FL)
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
JUNE 26, 1987

HEARING ON CORPORATE TAKEOVERS AND EMPLOYEE OWNERSHIP

Mr. Chairman, thank you for your interest in investigating problems that concern employee-owned companies and corporate takeovers. I am particularly concerned with the situation faced by Eastern Airlines (EAL) employees as a result of the Texas Air Corporation takeover.

I personally travel with EAL when I commute back and forth from my district in Hollywood, Florida, and Washington, D.C. Countless Eastern employees have told me of their complaints regarding employee harassment and mismanagement problems since Texas Air tookover Eastern. There is extensive documentation of management problems. For example, I have been advised that EAL attendents are being body-searched at the end of flights for evidence of Eastern property on their persons. Flight attendents are also being fired for a three to four dollar discrepancy in their drink money. Machinists have reported that planes are being repainted and sold off. They delays to passengers are innumerable. The confirmed health of EAL and employment of these employees in South Florida is a grave concern to me.

In spite of these management problems, each employee with whom I have spoken also has told me that he or she wants to keep their respective jobs with Eastern and wants to see Eastern Airlines survive as a viable airline. I sympathize with the situation faced by EAL employees. Although EAL employees who have specific grievances have filed court suits, I feel that these problems stem from the new management and not the employees themselves. It is time to take a hard look and review the relationship between employee-owned companies and corporate takeovers to lessen the adverse effect on our nation's workforce.

It is my hope that this hearing will do some good to those employees and companies involved in corporate takeovers.

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July 1986

INDUSTRIAL COOPERATION COUNCIL

SUBCOMMITTEE ON NEW OWNERSHIP STRATEGIES

Proposal: New York Center for Employee Ownership and Participation

Introduction

In December 1984 Governor Cuomo established the Industrial Cooperation Council by Executive Order 55. It's mandate was to develop a consensus around policies and programs which would address the issues raised by economic, industrial and technological change. The Executive Order set forth seven specific responsibilities for the Council, one of them being training and technical assistance programs for local economic development officials, financial institutions, business groups, labor unions and other interested constituencies regarding new forms of ownership, management, and financing. This could include a program of technical assistance and grants for feasibility studies for restructuring, firms and to encourage management buyouts and employee ownership.

In order to fulfill its responsibilities, the Council established three subcommittees, one being the Subcommittee on New Ownership Strategies. The subcommittee researched and discussed the role of employee ownership within the State's economic development strategy. An extensive survey was conducted of the current body of literature including case studies of employee ownership. Staff for the subcommittee contacted government, university and business leaders in New York and in other states with experience in programs which facilitate employee ownership. Based on the findings of this research and discussions within the Committee, a proposal has been developed for the establishment of the New York Center for Employee Ownership and Participation.

1.0 The Spread of Employee Ownership

Worker ownership has become very widespread. By the end of 1984, over 6,800 American companies employing about 10% of the labor force had some plan that shared ownership with the employees. In New York State over one hundred companies have some form of employee ownership. There are good reasons to believe that employee ownership will continue to grow. One authority in the field predicts that by 1990, 20% of the firms with 500 or more employees will be all or partially worker-owned. Contrary to popular impression, 98% of these plans were not set up in troubled companies or through employee buyouts of closing plants. Only 1% were set up in buyout cases, such as Weirton Steel, and the other 1% were set up in stock-for-wage swaps, such as Eastern Airlines.

2.0 Current State Policy

Employee ownership is an option in many and various circumstances and supports the State's overall economic development goals in the following ways:

1. As a means to involve employees in the company and improve productivity: One study found that employee ownership companies were 1.5 times as profitable as conventional firms. The rate of job creation in majority employee-owned firms has been found to be almost three times that of comparable conventional companies. Participation and full rights as shareholders are essential.

2. As a means to buy out an owner: Many viable closely held companies are liquidated at the owner's death or retirement. These are not failing companies but liquidation is the easiest means to realize its value, or the firm lacks the glamour, exceptional profits or market position that makes them worth the risk that business ownership entails, or the owner has no plan for getting out. Worker ownership is a viable way for them to get out as the tax code has been specifically designed to encourage this.

3. As a means to raise capital: Employee Stock Ownership Plans (ESOPs) are effective ways for companies to raise money.

4. As a means to divest a subsidiary or prevent the sale of a locally owned firm to a major corporation. This would stem and reverse the negative impact of capital concentration in conventional manufacturing firms where profits are moved from one plant for investment elsewhere, frequently out of the State or the country and/or into a different line of business.

5. As a means to prevent a plant closing and thereby save a failing company.

6. As a means of establishing cooperatives in labor intensive manufacturing and in the service sector for long-term employed.

7. As a means to make labor concessions more equitable and increase participation in the workplace.

Eighteen states and the City of New York have passed legislation encouraging worker ownership. Provisions vary widely from simple declarations of the state's positive attitude toward employee ownership to substantial technical assistance and financial aid. Since only four states enacted measures prior to 1982, it is too early for a conclusive analysis of the impact of measures currently in place. However, most state measures are principally reactive; their focus is the use of employee ownership to avoid plant closings, the most difficult condition for employee ownership. Furthermore it has been found by experience in New York State and in other states that simply changing the law is not an effective way by itself for spreading this form of ownership. Its major shortcoming is that State agencies are not equipped to the extent needed to provide necessary technical and educational assistance and under-funded when it comes to providing money for the crucial prefeasibility studies.

The most far reaching of any state effort to meet the problem of underfunding currently in effect is Pennsylvania's "Employee Ownership Assistance Program," passed in 1984. $15 million is allocated over three years. $3 million is available for technical assistance for buyouts and $12 million for loans. The technical assistance portion is limited to 50% of the cost of a feasibility study, and is in the form of a loan. If the study is negative, the loan does not have to be repaid. Project loans are limited to 25% of project costs or $1.5 million, whichever is lower. At least two-thirds of the employees must make an equity investment worth 10% of the purchase price. Employees must end up with a majority of the company's voting stock.

In the past several years New York has recognized the promotion of employee ownership as proper state policy by passing two major statutory enactments. In 1983, the Governor signed into law the "Employee Ownership Assistance Act" which provides the Department of Commerce with authority to promote the idea of employee ownership generally and to provide technical assistance for employee buyout efforts. The Job Development Authority can also issue bonds to provide loans for employee buyout efforts, with limits of 40% of project costs or $10,000,000, whichever is lower. Employees must end up with a majority of the voting stock.

Two years later New York State's law on cooperatives was amended to clearly recognize worker cooperatives as a legitimate form for doing business. The approach of the statute is generally prescriptive rather than proscriptive; that is, it sets out and legitimizes the basic cooperative structure, but leaves room for significant variation. It builds a basic corporate shell and then provides for ownership by the workers, democratic control, and allocation of profits and losses according to work performed. Apart from its direct legal function, the law will also play an important educational role both for workers and for those providing financing and other services for cooperatives.

Although New York State has provided the Department of Commerce with the authority to promote the idea of employee ownership and provide technical assistance for employee buyouts, it has never appropriated funds for this purpose.

It is the recommendation of the subcommittee that the State establish a Center for Employee Ownership and Participation which would serve as the focal point for educational and outreach efforts for employee ownership, have a limited in-house capacity for technical and financial assistance, act as a clearinghouse for referrals to outside consultants, and help facilitate the vitalization of employee ownership as a method of doing business. A State program would have the greatest impact on employment in four major areas.

1. In assisting employees who are threatened by a shutdown or corporate relocation out-of-state to buy the firm;

2. In assisting retiring small businessmen in selling their company to their employees rather than liquidating the business or selling to competitors;

3. In encouraging the use of employee ownership, especially co-ops in start-ups of labor intensive service and manufacturing companies;

4. In anchoring capital in the state. Employee owned companies are unlikely candidates for relocations to other states or overseas;

3.0 Functions of State Program in Worker Ownership and Participation: Three Major Functional Areas

A. Education and Outreach
B. Technical Assistance
C. Financial Assistance

More specifically the functions would include:

a. Develop, collect, and disseminate information useful to persons and organizations throughout the state in undertaking or promotng the establishment and successful operation of employee-owned corporations.

b. Evaluate the feasibility of a proposed employee-owned corporation by providing the preliminary analysis, either directly or through consultants, as to the economic viability of proposed buyouts, start-ups or conversions.

c. Raise and allocate money for prefeasibility studies, business and marketing plans and gap financing.

d. Provide technical assistance, either directly or through referrals to appropriate consultants, to persons who seek to form an employee-owned corporation or co-op.

e. Assist persons in obtaining financing for the purchase and operation of an employee-owned corporation.

f. Act as an ombudsman or advocate for worker ownership projects by promoting and coordinating the efforts of local, state, federal, and private agencies to assist in the formation and operation of an employee-owned corporation.

g. Develop a strategy for helping employers with partial employee ownership to convert to majority ownership.

h. Provide educational counseling and training on employee participation programs and in the operation of an employee-owned corporation.

i. Recommend appropriate legislative or executive action to enhance opportunities for employee-owned corporations in this state.

Education

Despite the growth of worker ownership since 1974, the greatest barriers to realizing its fullest potential are lack of public awareness, faulty knowledge, and ignorance about where information can be obtained. Workers facing a shutdown or a businessman who wants to retire may never know or may learn too late that worker ownership is a viable option.

A well designed public education program must be structured to speak to the interests of many different constituencies, each of whom plays a role in establishing a worker-owned company. These include workers, small businessmen, lending institutions, unions, local insurance companies, real estate brokers, investment bankers, chambers of commerce, local development corporations and church groups.

A public program should stress the advantage of worker ownership but make the disadvantages of such a structure known as well. The benefits and the risks should be clearly enunciated.

To implement its education and outreach function the Center should hold regional conferences with the different constituant groups. On request, staff of the Center should also be available to meet with small groups on a project-by-project basis on request. If needed, Center staff would work with a company considering the establishment of a participation program through the process from its deliberations from the initial identification of the need for change to implementing and then evaluating, and if necessary, revising its plan.

The Center should compile a handbook and resource guide which enumerates a typical conversion, step-by-step. The guide should also contain lists of consultants, private and public organizations that can assist with information, technical assistance and resources, other publications and articles and the provisions of the major state and federal laws affecting employee owned companies.

A consultant should be retained to help design and implement this educational work of the Center.

Technical Assistance

Workers and companies who are considering a conversion or buyout may need professional expert assistance in order to make an informed decision. The Center will act as a centralized office to support preliminary analysis to determine whether the company should be considered for public financial assistance.

Actual assistance in completing preliminary and full feasibility studies, marketing and business plans and financial packages should be done by non-government staff. The State agency might consider contracting with an outside professional organizaton to perform technical assistance services. This unit might also be responsible for arbitration of disputes between management and workers attempting to negotiate a buyout.

Financial Assistance

The principal source of funding for employee ownership has already been provided by the federal government in the form of a Federal tax subsidy to ESOPs, an annual tax expenditure of about $2.5 billion that is expected to rise to $4.4 billion by 1990. However, additional financial assistance is needed for companies and workers who are prevented from making decisions because of lack of information. Funding for prefeasibility studies is particularly important. Assistance is also needed for feasibility studies, marketing and business plans, loan packaging, training programs, working capital, equipment and real estate loans. Gap financing for start-up situations is especially helpful.

The Center will help integrate worker ownership into existing economic development programs. State funds should be used to leverage commercial loans through loan guarantees, interest rate subsidies and making subordinate loans. Some combination of matching grants and a working loan fund could also be used. Some states have created venture capital funds that use Government and private dollars to make equity investments to new firms.

Alternative Sharing Arrangements: A Review of the Evidence of their Effects and some Policy Implications **

by

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Abstract

The available theoretical and empirical evidence on the economic effects of alternative "sharing arrangements" is partially reviewed. From this, as well as consideration of other non-economic arguments, is derived a package of initiatives in workplace democratization and participation for the U.S. The package has two halves. First are proposals to expand the sectors in which workers have majority ownership and control. The discussion outlines which industries should be emphasized, the appropriate enabling legislation and how this might be financed. There follows a discussion of policies designed to encourage more modest expansions in worker ownership, participation and profits.

** This paper has benefitted from comments by an anonymous referee and Corey Rosen and my discussions with Khurseed Choksy, Saul Estrin, Eric Siegel and Stephen C. Smith.

I Introduction

Alternative systems of business organisation and of worker's remuneration recently have become the focus of considerable attention. Since the major stimulus has been the work of Weitzman (1983, 1984, 1985a, 1985b, 1986), most attention has consequently focused on the particular alternative favored by him, profit sharing, and on the particular crucial issue raised by Weitzman--the enormous potential importance of structures internal to the firm, especially those that provide for flexible pay, in determining macro outcomes. Yet as has been pointed out (e.g. Meade, 1986) there are an enormous variety of possible "sharing arrangements". Moreover, apart from the possible effects of sharing arrangements on stagflation, there are potentially many other important ramifications, including effects on productivity, investment and industrial relations.

In Meade's taxonomy of possible sharing arrangements (see also Vanek, 1975) the crucial distinctions are, on the one hand, whether or not workers own stock in the company and, on the other hand, whether or not workers participate in decision making. This produces four basic types of sharing arrangements which differ according to the particular channel(s) of participation that are emphasized. In profit sharing schemes (of the kind advocated by Weitzman) employees neither own stock nor exercise control over the business. What is different from a conventional firm is that labor is remunerated, at least in part, by a share in cash of the firm's profits or, employees participate in profits. In employee share ownership schemes, employees own shares in the company in which they work, but do not exercise much influence over the firm's operations. (Most U.S.employee stock ownership schemes (ESOPs) are of this form). Here the stress is on financial participation, but with ownership (rather than profits) the key channel. A third basic type is the labor managed firm. Here workers (or their agents) are the key decision makers in the firm and, even though usually workers will own the majority of the voting stock, it is decision-making participation (rather than financial participation) that is stressed. The fourth type is what Meade calls a labor-capital partnership. While workers do not own shares in the corporation, with capitalists they share in both the enterprise's revenue and in decision making.

While this is a useful taxonomy, it is important to remember that each of these four basic divisions in fact includes a variety of forms whose economic behaviour may differ in one way or another from the prototypical firm within that category. For example, in Weitzman-type sharing firms, sharing might be linked to revenue or value added, rather than profits. The behavior of labor managed firms may be strongly affected, amongst other things, by the rights of new workers to be admitted at some future date to membership of the firm and the capital structure of the firm (Estrin and Jones,1987).

As well as the need to be aware of the wide variety of "sharing arrangements", and without downplaying the enormous potential importance of the macroeconomic consequences of these arrangements, it is also important to recognise that the economic consequences of these alternative forms of contracting are potentially much broader than the effects on stagflation. Moreover, while frequently the consequences (usually the advantages) alleged for the "share economy" are believed to be applicable to all variants of the share economy, sometimes arguments are advanced that apply only to specific alternatives.

The potential policy relevance of research in this area is reinforced by two related concrete developments. First we observe the international growth of forms of the share economy. Whereas in 1981 in the U.S. there were about 5300 ESOPs covering about 4,250,000 workers, by 1986 there were (excluding PAYSOPs) about 7500 ESOPs covering 7,500,000 workers. Of these, 12 majority employee-owned firms ranked among Forbes'list of the 400 largest private firms (N.C.E.O.,Dec.1986). So far as profit sharing in the U.S. is concerned a survey in 1984 by the Bureau of National Affairs showed that 19% of employers have a profit sharing plan. Similar trends apparently are underway elsewhere. A survey in January 1987 revealed that in the U.K. about 4% of the adult population now own shares in the company for which they work (The Observer, Jan.18, 1987); this compares with virtually nil a decade ago (Oakeshott, 1984). A related development in most Western economies has seen the growth of producer (worker/industrial) cooperatives (PCs), firms in which worker ownership is coupled with workers (or their agents) exercising the controling influence over decision-making in the firm. One authority estimates employment in Western European PCs at about 500,000 (Sibille, 1983). Many ascribe the success of the Japanese economy in part to its payment system whereby about one quarter of the average worker's total compensation is in the form of a twice yearly bonus (Weitzman, 1986).

Second, already there have been, and it looks as though there will continue to be, legislative initiatives in this area both in the West and possibly elsewhere too. For example, in the U.S. in 1986 the new tax law has generated more interest in ESOPs and 18 states and the city of New York have passed legislation encouraging worker ownership, with 14 of these states doing so during the last five years. Moreover, various states, including New York and Massachusetts, have introduced legislation that encourages the formation of PCs. In the U.K. the growth in employee ownership has been caused, at least in part, by the amendment to the Finance Act in 1979 and to various "privatization" measures. Also, in the April 1987 budget the U.K. government expressed strong support for the merits of profit related pay and endorsed the granting of tax relief to encourage the adoption of such schemes.

Several basic issues are raised by these developments. Will these trends of growing worker participation in decision-making, in ownership and in profits continue, or are they more likely to halt or even to be reversed? Will this be an area of sustained research interest, or rather another passing academic fad? Most importantly, what is appropriate public policy in this area? Are the various fiscal initiatives that have been taken to promote different forms of sharing justified? In this paper I argue that both interest in and growth of sharing arrangements will continue. Moreover, additional policies to encourage these developments should be introduced. The plan of the paper is as follows.

In the next section I note some of the major arguments for (or premises underlying) elements in the package of proposed policy proposals. The policy package has two halves. The first half of this package, involving a substantial expansion of the sector in which enterprises are largely owned by workers (hereafter the cooperative sector), the industries that existing knowledge indicates should be emphasised, appropriate enabling legislation and how this might be financed, is considered in section three. This is followed by a discussion of other initiatives that would apply to nearly all firms in the private sector. Various ways and means of expanding the degree of worker participation in decision-making and/or in ownership and/or in profits are considered.

II The Case for More Public Policy on Sharing

Before considering reasons for introducing initiatives in this area, it is interesting to note that these notions have deep intellectual and political roots in the United States. Concerning employee ownership, some early American professional economists, including the first secretary of the American Economics Association, Richard Ely, enthusiastically endorsed the idea of worker ownership via worker cooperatives. Russell (1985:10) notes how since as early as 1849 there have been public officials who have advocated the extension of worker ownership. The idea has recurred throughout American history with intense interest at particular times, such as during the 1920's. More recently the idea has been championed by Kelso and Senator Long. The recent rising tide of interest has led to numerous initiatives in this area both at the federal level (reviewed by Whyte and Blasi, 1981) and at the state level (see Rosen, et al., 1985).

The basic rationale for initiatives in this area is an ethical one. All initiatives, (but especially those which emphasize worker participation in decision making) would serve to give workers the potential for more control over the organizations that shape their working lives. As such initiatives would help to produce modes of economic organisation that internally are more democratic than most conventional organizational structures. Thus as Dahl (1985) argues the initiatives are desirable on idealistic grounds--they extend the democratic ideal beyond the political into the economic realm.

Another argument for introducing democratic initiatives is that this helps to serve basic human needs such as self-actualisation. Human-centred technology is found much more commonly in enterprises in which there is significant worker participation in decision making.

There is also abundant empirical evidence that, on average, levels of job satisfaction of workers in both participatory firms and worker coops tend to be higher than levels experienced by workers in other firms (1). This is especially the case in relatively smaller firms.

There is also some evidence that fostering the spread of worker ownership should be encouraged because it is in keeping with people's preferences. A poll by Peter Hart Associates indicated that 66% of American workers would prefer to work in a firm in which they could have a substantial ownership stake. Another poll by the U.S. Chamber of Commerce reveals that 84% of the workforce would like the opportunity to participate in management decisions. Presumably, both financial participation and decision-making participation are viewed as providing the potential for more involvement, compared to capitalist firms in which workers have little sense of involvement or influence, especially over key isssues such as plant closure and corporate mergers.

One can also argue for the development of policies designed to encourage the spread of worker ownership because there are important historical precedents. Examples of firms with substantial employee ownership have existed here since at least 1791 and there have been recurring waves of formation since then (Jones, 1984). Most importantly, the last fifteen years has witnessed a resurgence in the autonomous growth of producer cooperatives and of firms in which there is some employee ownership (Russell, 1985).

While the preceding points are substantial and should not be slighted when formulating policy, in the current economic climate it is more narrow economic considerations that will loom largest in most people's minds. To these we now turn. At the outset, it should be noted that a lot of theoretical and empirical research remains to be done.(2)

In the rest of this section, I will briefly review the available evidence on key issues for various forms of the share economy. Since the economic theory on this is probably better known than the empirical evidence, I will concentrate on the preliminary empirical evidence on important issues, especially work that I (together with other colleagues) have been doing for employee-owned firms in the United States as well as in Britain, France, Italy, and Poland.(3)

We begin with a consideration of what for Weitzman is the crucial issue, the effects on employment and wages. For a Weitzman-like profit-sharing economy there are two important points. Weitzman's key argument is that, by reducing the marginal cost of labor, the introduction of profit sharing will increase the overall average level of employment in the economy. In an economy of monopolistically competitive and profit sharing firms, when a firm expands its production, prices necessarily fall. Hence the expansion creates an external benefit to other firms which, in turn, will produce further expansions of output and employment. The other claim is that the variability of employment will be reduced. The claim that profit sharing firms will have excess demand for labor implies that employment will be less variable in the face of shocks than would be the case with conventional fixed wage firms. While we will not review theoretical objections here(4), it is important to note that many critics disagree on both of these points (e.g. Estrin, Grout and Wadhwani, 1987) and predict instead that an economy of profit sharing firms will have neither a greater average level of nor less variation in employment.

Turning to other sharing arrangements, the effect on employment can be expected to vary according to the particular nature of the sharie economy. Thus if firms distribute profits to workers in the form of shares (rather than cash), and the share parameter is fixed, then this form of employee ownership would be expected to have effects that are similar to profit sharing where the worker is remunerated in cash.

This contrasts sharply with the income-maximizing labor managed firm which is predicted to restrict employment (Meade, 1986). By using more complex (realistic?) behavioural rules than the simple "maximise income per worker" assumption, however, others argue that a sector of worker coops will be effective in creating and maintaining jobs. (5)

The available empirical evidence on the employment and wage effects of varieties of the share economy is very slim and does not yet provide clear cut results. Most work has dealt with the Japanese economy. But even for the more careful studies here, the evidence is contradictory --compare Freeman and Weitzman(1986) with Wadhwani(1987). For the U.K. while Estrin and Wilson (1986) find a strong positive effect of profit sharing on employment, they attribute this to the effects of higher productivity rather than to the Weitzman "wedge"effect. In a study of various labor-mamnagement committee initiatives (including the pioneering case of Jamestown), Whyte et al. (1983) show how such schemes have had diverse favorable impacts, including employment growth and reductions in absenteeism.

For worker coops, the available empirical evidence is often difficult to evaluate. On the one hand,it is apparent that in no country has there been sustained and massive job creation in the worker coop sector. And there exist many examples of individual worker coops, that were formerly capitalist firms, soon perishing without any long-term job gains--e.g Rath Meatpacking here and Meriden and K.M.E.in Britain. Sometimes, as with newly established coops, this reflected ultimately doomed attempts to establish firms at sizes below minimum efficient scale, either because of capital shortages or ideological preference for smallness. Also the historical landscape is dotted with instances of what were once flourishing coops disappearing. In some cases, as with the Minneapolis cooperages, it seems that aging workere were collectively unable to respond to rapid technical change and demand fluctuations. At the same time there are conspicuous success stories. For example, Sibille (1983) reports that during 1976-1981 Italian PCs created 80,000 jobs. At least as impressive is the record of the Mondragon coops who, during the recent recession, maintained a policy of no layoffs and even managed to show some modest growth in employment. Also, evaluations of the cost effectiveness of job-creation in worker coops are nearly all encouraging--note, for example, the low estimates for cost per job created found in UK contemporary coops and in extant U.S. worker owned firms. During the Great Depression, in the U.S. worker coops were found to be a cost-effective way of rehabilating the unemployed during times of generalised unemployment(6). In sum it seems clear that, from the perspective of jobs, there are certain sectors in which worker coops will likely do well and others in which the outcome will be much more uncertain. Sectors to be avoided are those in which demand fluctuations are pronounced, technical changes are rapid and large capital reqirements are the rule.

A second and more traditional argument advanced in favor of profit sharing is that it will produce improvements in enterprise productivity. The economic theory underpinning this prediction tends to be fairly informal (7). Stress is placed on the possible incentive effects of profit sharing, as well as the belief that profit sharing will lead to greater identification between workers and the firm and hence to a replacement of negative by positive collusion (Cable and Fitzroy, 1980).

Again we will not review the counter-arguments here. Suffice to note that some theorists, notably Jensen and Meckling (1979), predict that profit sharing will adversely affect enterprise performance.(8)

When profit sharing exists in conjunction with employee ownership -- profits are distributed as shares and the share parameter is fixed--then the arguments made above for profit sharing alone may be expected to carry over to this case. Indeed Cable and Fitzroy(1980) argue that, because of an especially strong incentive effects and sense of attachment to the firm, there may be a powerful interactive effect so that the combined impact of profit sharing and employee ownership might exceed the sum of the two effects considered alone. Furthermore,there may be other reasons why productivity might be expected to improve.(9) For example, employee ownership (with or without worker participation in decision-making) may lead to an increase in the propensity for the worker to stay with the firm and therefore lead to augmentation of their firm specific human capital. On the negative side, the strongest case is made by Jensen and Meckling(1979) who see employee ownership (and worker participation) as always having a deleterious effect on productivity. The pessimists focus on problems resulting from information sharing and joint decision making, and suggest that these features will lead to poor choices. Inefficiencies may also result from participation in decision making because of problems in group preference formation when worker's tastes differ, leading to slow and cumbersome decision-making. The implication of these arguments is that negative productivity effects would be expected to be most apparent in firms in which worker control and ownership are most developed, i.e. in labor managed firms.

Turning to the available empirical evidence on the effects of sharing on productivity, the bulk of the informal (survey and case study) evidence finds that, for most forms of sharing, the effects on indicators of performance such as absenteeism, labor turnover and "the industrial relations climate" , tend to be percieved by different economic agents as largely positive (e.g.Long,1978; Broderick and Mitchell,1986).But often there are suspicions that, even if these effects are real, they may not endure. Also other and often more careful recent studies find negative effects -e.g. Cable (1986) for German sharing firms.

Other studies employ ratio analysis to examine the performance of sharing and non-sharing firms. Recently, Rosen et al. (1985) use a variety of indicators, including productivity, to show the economic effectiveness of mainly cases of minority employee ownership in America today. When the performance of worker cooperatives is compared with that of privately or state owned firms it seems reasonable to conclude from the available evidence that cooperatives are able to perform at least as well as their counterparts. For the U.S. there is abundant evidence on this for plywood coops compared to other firms and for earlier producer coops too (see Jones, 1979). Elsewhere, we find that during 1960 to 1980 the technical efficiency of Polish coops was as least as good as Polish state firms. In particular, coops seem to have made more efficient use of capital than state owned firms (Jones, 1985). The relative success of the Mondragon coops is also well established (Thomas, 1982) and there is evidence of strong performance by large Italian manufacturing coops relative to capitalist firms (Zevi,1982).

Perhaps the most reliable view of what is happening is derived from the econometric evidence.(10) For the U.S. the main study is still Conte and Tannenbaum (1978). The authors find that higher levels of equity ownership by workers are associated with greater levels of enterprise profitability. Using data for German firms, Cable and Fitzroy (1980) find that productivity will be boosted when minority worker ownership coexists with profit sharing. For profit sharing firms the preliminary evidence is contradictory with Estrin and Wilson (1986) finding a positive effect while Blanchflower and Oswald (1986) do not.

Most econometric work on this issue has dealt with forms of labor managed firms. Here consistent results are beginning to emerge. Analysis of worker coops shows that the productivity effects of various forms of worker participation in cooperatives differ markedly from one institutionmal setting to another. However, in general we find that, overall "participation" is associated with higher productivity. In worker coops the positive effect is found most uniformly with respect to profit sharing and, to a slightly lesser extent, individual capital (share) ownership by workers. Participation in decision-making is never found to lower productivity. But in some cases, notably worker cooperatives in Poland, some French coops and Italian manufacturing cooperatives, the effect is strongly positive. (Estrin, Jones and Svejnar). In British retail coops too, the presence of worker directors has been found to enhance enterprise productivity (Jones, 1987). Within worker coops, individual worker loans to the coop are not related to performance while collective capital ownership exhibits an insignificant or a negative productivity effect.

Little detailed work has yet been completed on income distribution. Various ad hoc arguments have been presented as to why there might be higher distributive efficiency both within individual firms with sharing arrangements and among firms within a sector of sharing firms (Vanek, 1970).On the empirical front, with respect to income distribution for worker coops in Poland during 1976 to 1981, comparisons at various levels of aggregation using several measures of inter-enterprise income distribution show much smaller dispersion between coops than between state owned firms. In the West there are important examples of earnings differentials within worker coops deliberately being kept within bounds that are narrower than found in comparable capitalist firms--e.g.plywood coops in the U.S. and coops in Ravenna and Mondragon.

The evidence is rather different for firms with limited degrees of employee ownership (and presumably, therefore, for enterprises with only profit sharing). Thus a recent study (G.A.O., 1986) finds that the growth of ESOPs in the US has not led to the accumulation of significant capital holdings by the average employee in an ESOP firm. Consequently we would not expect to find that ESOPs have had much effect of the distribution of income (and wealth) in the US.

An area of major concern for many is the possible adverse effects on investment that sharing arrangements might have. Meade (1986) has argued that investment will be discouraged in profit or revenue-sharing firms. Under an inflexible agreement with labor that it receive a fixed proportion of (say) net revenue, there would be a serious disincentive for owners to undertake an investment, since the net return of the investment to the owners would be considerably less (by a factor equal to the share parameter) than it would have been without sharing. For labor managed firms too numerous analysts have posited underinvestment as a fundamental problem (see particularly Vanek(1975), Furubotn and Pejovich (1970). Property rights theorists stress the alleged "attenuation" of individual ownership rights in labor managed firms. The argument is based on the fact that the normal property rights in such firms prevent individual workers from trading their implicit equity stake. Thus in financing enterprise investment internally by providing the corporation with some proportion of their potential earnings, the labor force face a loss of principal which would not have occurred had they saved in any other financial asset. This "non-reuperability" leads workers to require a premium on returns to internally financed investment which represents a disincentive to investment--the "Furubotn-Pejovich" effect. There is also a portfolio argument. For all forms of employee ownership, it is sometimes argued that holding stock in the company in which he works will act ot reduce investment in firms in which risk-averse workers have influence.

But work by other theorists leads to different predictions, at least for some sharing arrangements. For example, Weitzman (1986) notes that, over the longer run, there will be a tendency for pay parameters to become more flexible and hence for the underinvestment effect to be dissipated in profit sharing firms. Also, if productivity is higher in sharing firms (say because of greater attacment to the firm or stronger incentives) this implies that the marginal efficiency of capital schedule (and hence the desired capital stock) will be higher than it would be for a conventional firm. This, in turn, would be expected to lead to greater investment. For firms in which there is profit sharing and workers own part of the company, Estrin, Grout and Wadhwani(1986) arrive at a similar conclusion, though the result follows from changes in bargaining power rather than attitudes. They argue that in imperfect labor markets bargaining between workers and management will lead to some of the negotiated wage being replaced with capital gains and dividends. This, in turn, may improve long run profitability and thus stimulate investment.

Very little empirical work testing these conflicting predictions exists. The available qualitative evidence for long-established British worker coops and U.S. plywood firms would seem to substantiate the underinvestment proposition. But for the case of French producer cooperatives Estrin and Jones(1987) find no evidence of serious underinvestment. None of the variables stressed by theorists of the labor managed firm are associated with underinvestment. In other words, low demand for investment is not necessarily a major problem that besets worker coops. To the extent that underinvestment has been a problem in worker coops this probably largely reflects the particular institutional structures that have existed in those firms acting to constrain the supply of funds that are generated internally together with discrimination against worker coops by existing banks and lending institutions. For other forms of the share economy the only econometric work (Blanchflower and Oswald, 1986) accepts the hypothesis that investment does not depend upon stock ownership by workers.

Another issue of interest is whether or not the life cycle for and survival potential of firms with alternative forms of business organization differs systematically both among firms with differing share arrangements and also compared with conventional firms. Here the theory is best developed for the labor managed firm and many authors have expounded theories which imply that all labor managed firms will display some sort of a life cycle. Disagreement remains over the underlying determinants and ultimate consequences of the degeneration process, with analysts citing both the structure of ownership and capital formation (see Vanek, 1971 reprinted in Vanek,ed., 1975) or the use of hired labor (see Miyazaki, 1984 or Ben-Ner, 1984). But there is almost general agreement among theorists that labor managed firms will either fail as productive units in the long term or convert into another form of enterprise. While this theoretical pessimism as to the survival potential of labor managed firms will not necessarily carry over to theories dealing with other forms of sharing, it does, at least, provide pause for concern.

On the face of things the American experience is supportive of this pessimistic position (Russell, 1985). However, there are cases of U.S. coops surviving for more than one generation (Jones, 1979). For British PCs, Jones (1975) finds that not only can they survive but they may survive for periods longer than for comparable capitalist institutions. More generally, Ben-Ner (1987) finds that for worker-owned firms in several countries, overall they suffer a lower risk of demise than do capitalist firms. Also, the most comprehensive and reliable available evidence on life cycle (Estrin and Jones, 1986), while revealing a life cycle process for coops, indicates one that is rather different than envisaged by existing theory. The life cycle process for French producer coops neither stresses nor conforms with in any systematic way the variables given pride of place by theorists in this area--pay, productivity and worker-membership ratios. Instead we find that massive changes in capital structure are apparently central to the life cycle process as firms age. As yet there is little firm evidence on other related issues, such as the determinants of the rate at which different forms of sharing are established and the mortality rates for these firms with such schemes as compared to firms with fixed wages. Furthermore, experiences elsewhere categorically refute these short-lived/life-cycle propositions for coops. Thus in Italy there are flourishing --Fortune 500 equivalent --worker coops that have existed for more than one hundred years.

Trying to derive conclusions from this preliminary work on which to base policy is, of course, a hazardous undertaking. My reading of the available evidence is that, the usual caveats notwithstanding, under certain cirumstances, the case can be made that all forms of sharing arrangements result in improvements in economic welfare compared to levels that would have prevailed under conventional arrangements. From amongst the broad class of sharing firms, the economic benefits tend to be greater the higher the level of worker participation in decision-making and where there is also financial participation through profit-sharing or ownership stakes. Of the various possible forms of sharing, the available evidence is weakest in demonstrating the economic benefits associated with the existence of profit sharing alone.

But if this reading of the evidence is broadly correct, the skeptic might ask why then are sharing arrangements comparatively rare in the real world, especially PCs? Furthermore, if sharing arrangements have these economic and non-economic advantages, why then does one need to justify more aggressive public policy so as to encourage a broader and deeper range of experimentation with diverse forms of sharing arrangements? Answers to questions such as these require addressing the crucially important issue of formation. While serious work on this topic is still scarce,(11) there are at least two sets of arguments that can be advanced. First, policy to stimulate the formation of participatory firms is justified because there may be important impediments in today's economy to the rapid formation of these alternative arrangements. Several authors (e.g. Vanek,1970; Jones, 1975; Horvat, 1975; and Putterman, 1982) have identified a variety of legal, institutional and attitudinal factors that obstruct the establishment of participatory firms. Second, a variety of important externalities may result from the spread of sharing arrangements. For example, Weitzman (e.g.1984) has stressed the macro-economic benefits that might result through the existence of tight labor markets in an economy of profit sharing firms. In view of the previously documented efficiency advantages of *established* PCs, and given the observed tendency for successful PCs to cluster, there is an second though related argument for fiscal initiatives designed to promote the formation of groups of PCs --an "organizational infant" policy. That is, policies would enable collections of PCs to overcome initial obstacles, and to achieve the threshhold beyond which they would be able to provide full benefits to society. Other illustrations of this point are the various mainly non-economic externalities that might result from the spread of sharing arrangements. For example, Smith (1975) finds evidence in support of the hypothesis that increased decision-making participation within the firm is mutually reinforcing with participation in the political process within the community.

The merit of these and other arguments is reflected in recent initiaitves in the U.S.[12] The need for appropriate legislation to govern worker owned firms is seen in the spurt of legislative activity in this area, particularly at the state level. That legal initiatives alone are insufficient (and that complementary activities are unlikely at this juncture to be undertaken by other agents, such as the established coop movement), is recognised by government adoption of other initiatives. These include the establishment of a Centre for Employee Ownership and Participation by New York State, an agency which will help to foster the growth of worker ownership by various activities such as the provision of technical assistance and education.

While most of these programs are valuable my basic contention is that, for the most part, they amount to a useful beginning and that many more additional initiatives are needed. I believe that it is both economically sensible as well as desirable on more general grounds to introduce additional policies that will lead to an expansion of sharing arrangements. Amongst the possible varieties of the share economy, for the reasons outlined, measures should be designed so as to promote the expansion of the worker cooperative sector. But the package of policy measures should also contain other measures that have more general applicability. In the following section I outline such a policy package. Of course, these recommendations are necessarily preliminary and not as detailed as one might wish. First are proposals to expand the sectors in which workers have majority ownership and control. The discussion outlines which industries should be emphasized, the appropriate enabling legislation and how this might be financed. There follows a discussion of policies designed to encourage more modest expansions in worker ownership, participation and profits.

At the same time, in advocating policies designed to foster the growth of firms in which there is majority ownership by all workers, it should be stressed that it is abundantly clear that such firms are never a panacea for all the problems that beset the modern enterprise. They may not always represent the industrial policy that is consonant with the best interests of the involved workers. But I am persuaded by the available evidence that various initiatives should be undertaken to facilitate the growth of a much larger sector of such firms than presently exists. On balance and when introduced in appropriate circumstances and with viable structures (key elements of which are individual ownership stakes and strong supporting structures), the introduction of worker cooperatives often does yield substantial net benefits to society.

III Measures to Support an Expanded Worker Cooperative Sector

In the short term (say five years) a feasible goal with respect to sector comprising firms in which workers owned a majority of the voting stock, would be to aim for a sector that generated jobs for 100,000. To put this in perspective, if this target were achieved this would represent about a tenfold expansion of the existing sector and would make the American worker coop sector the second largest in the West, behind only Italy though well ahead of Mondragon and France.

To achieve this target a series of measures, primarily of an enabling (rather than a directive nature) would be needed:

First, in order to provide for a coherent policy in design and execution it would be necessary either to establish an Institute for Worker Ownership and Workplace Democracy or to establish a body with similar responsibilities but as part of an existing agency (preumably the Department of Employment). Either institution would be staffed by people with appropriate backgrounds and relevant technical skills. If the institute were autonomous its governing body would include representatives from institutions at the state level, such as the Industrial Cooperative Association (ICA) and various development agencies. This Institute would fulfill the roles and functions that some theorists argue need to be supplied by a supporting structure. Also, it is noteworthy that a characteristic of successful worker cooperative movements, past and present, is the existence of such a body. Today we note the Caja Laboral Popular in Mondragon, CGSCOP in France and in Italy institutions at regional and national levels to support Lega and Confederation coops. Formerly, organisations have existed at the industrial level in the U.S. which undertook a limited number of these support tasks.For example, in both shingle weaving and plywood, most formed, often by young,highly educated professionals. Sometimes these are labelled "knowledge-based" activities. Again there is some historical precedence here. As with the previous area, to avoid concentration in areas which many regard as primarily using older (or even outmoded) technologies, the third line of activities to be encouraged are "high-tech". For capitalist firms in this area, frequently the productive unit is small (at least in terms of numbers employed) and work units are cohesive with "participatory" modes of decision-making the norm. In principle, this would seem to be an area that would suit a worker coop structure and the experiences of Mondragon coops in this respect is deserving of more careful inspection.

Worker owned firms would also be expected to emerge from transformations of erstwhile capitalist firms. There is an urgent need to develop systematic public policy in this area, rather than having to rely on largely ad hoc responses to particular cases. Legislation to encourage worker buy-outs, with provisions for loan and tax incentives would be implemented. These should be structured so as to to have broad appeal for all workers in a firm and not just management. Also, this legislation would apply to all firms and not only to capitalist firms in crisis. It is extremely important that scarce funds be allocated to encourage conversions of successful capitalist firms and not to concentrate energies alone on bailing out "lame-ducks". In some cases this will be easily arranged because owners are responsive to tax considersations or have genuine philanthropic motives. It is probable that this segment of the worker coop sector would be heterogeneous.

In all instances where national public funds are involved--both new coops from scratch as well as transformations--the launching of specific ventures and the granting of financial assistance would take coops belonged to bodies actively engaged in promoting sales of member organisations and limited propaganda.

Today most of the institutions that exist to support American worker owned and controlled firms are private organizations such as the ICA and the Philadelphia Area Cooperative Enterprises (PACE), that self-finance much of their activity through paid consultancy work. But increasingly, reflecting the growth in legislation, we see the emergence of government-funded bodies which operate mainly at the state level, such as the Centre for Employee Ownership and Participation in New York State. However,a national body, the Cooperative Bank does exist and provide modest levels of assistance. While the existence of organizations such as ICA and PACE is an important phenomenon (and one that is deserving of active encouragement), it is clear that the institutional structure that exists to support worker coops in the U.S.is defective in important ways. For example, decisions about which activities to encourage the growth of coops in tend to be made at the State level by agencies that often are thin with respect to appropriate technical expertise and/or cooperative backgrounds. No overall strategy exists to guide the development of a worker coop sector but rather decisions are made on a piece-meal and ad-hoc way in different localities. Often decisions have been made for ailing firms and under crisis conditons. A clear need exists, therefore, for a single national organisation to complement the existing and largely decentralized institutions.

One task of this body, therefore, would be to develop an overall strategy for such an enlarged coop sector and, at the same time, to provide a pool of entrepreneurial resources at the national level so as to make this overall strategy possible . Much attention would be given to the matter of the industries that are most appropriate for worker coops. And it is here that economic theory and empirical analyses of coop experiences, as indicated above, may be helpful in designing policies that are appropriate to the present situation. The most prudent policy would probably be to encourage the further development of worker coops in those areas in which they have tended to develop without major state initiatives, areas where demand tends to be steady, competitive pressures are not overly pressing and technical progress takes place at a regular pace. Today this would mean in part further stimulus of sectors in which there is already a significant worker coop presence--areas such as printing, lumber, bookstores and services such as retailing in general and food distribution in particular.

It would also mean a more significant expansion in areas in which American worker coops once were more visible or where contemporary experience elsewhere suggests room for marked growth. Three areas come to mind. First there is building. In both France and Italy today construction coops are very significant--in Italy they account for about 9% of the national market. And there have been some examples of successful construction coops in the U.S.in the past. Further, to the extent that federal policies were to contain an incresed emphasis on public sector capital projects, a strong boost to the formation of new worker coops in construction could be provided. In addition, should a new government pledge to create conditions whereby the rate of addition to the housing stock were to be substantially increased (over what it has been in recent years), by providing a new market this could also act as a stimulus to the development of new worker coops in building. A second area is indicated by recent experiences in France where, since the mid 1970s, many coops in consulting (and related fields) have been place only when projects had met with approval by technical experts at the Institute. The existence of a single on-going body, such as the proposed Institute, would enable a separate accounting and social evaluative framework, which was cognisant of the special aims and purposes of coops, to be developed and used consistently. The instrument would be designed with the unique legal needs of worker coops in mind too. Thus in considering the launching of rescue coops, this framework should be designed so as to capture worker and community costs and benefits. To monitor and evaluate performance in on-going coops, this should include information on aspects of membership such as age distribution and aspects of governance such as attendance at meetings. In addition it is assumed that there would be active cooperation with state officials and, particularly in the case of rescue coops, from appropriate labor unions as well. Once the project was launched, the Institute would continue to provide certain services--such as auditing and technical expertise--and to do this particularly carefully during infancy when the risk of mortality is highest. Also, in nurturing a viable worker cooperative sector, it is important to guard against the dangers of creating firms that are unneccesarliy dependent for survival on federal/state government grants.

A second task is to advise on the issue of viable structures. As indicated above, while the available evidence does not suggest that there is a single model that should always be implemented, there are some lessons to be drawn as to which structures to avoid. Some of these points are as follows:

(a) The ethical basis for the cooperative relates to creativity and work. To this end rules should be adopted which allow only current workers to become members. When a worker-member retires or leaves the firm, membership would lapse. Current workers who wish to become members should be freely admitted (subject to fulfilling obligations such as furnishing a capital contribution--see on). While membership should be encouraged of workers it should not be mandated.

(b) Membership should require the underwriting of a meaningful individually owned stake in the enterprise. A target membership fee might be a sum equal to three months earnings. These individual stakes are to be remunerated at the appropriate market rate.

A third task of this umbrella body/division of the Dept. of Employment would be to provide education and training to members of coops. This will be of several kinds. Included will be the training of workers, especially those elected to representative bodies, in various technical skills such as basic accountancy concepts. For managers, it will be vital to instruct in participatory modes of leadership.

Second, to deal with the problems of shortage of financial capital and especially the need for seed capital the following inter-related measures would be introduced. To respond to the problem of bias in the capital markets, a Bank for Worker Ownership would be established. The majority of the bank's loans would be required to be made only to worker coops (the balance would be to firms in which there was some though not a majority ownership stake by workers). To attract deposits, various measures might be considered. Deposits might be insured by the government, at least up to some amount, say $25.000. Lenders in general could be given a marginal tax advantage in terms of the taxes due on interest earned on deposits kept with this bank. This tax advantage might be substantial in certain cases. For example, workers who made systematic medium-term loans (say for five years) by payroll deductions would be rewarded when the loan matured by the payment of a substantial interst premium/tax refund. In addition, during the first few years of the bank's existence, the government might consider making a special grant in order to establish a revolving loan fund.

Third A variety of fiscal incentives would be introduced both to provide incentives for mainly unemployed workers to gather to form new coops and and for existing coops to employ additional workers. Enterprises would be entitled to receive a cash grant equal to a substantial premium over the average previous unemployment benefits (say 20%) of the new workers. In return, the new workers would receive a like sum, but in the form of a deferred equity credit. This would immediately appear as a liability in the enterprises' accounts, but like regular capital contributions, would not ordinarily be withdrawable until retirement. The usual spectrum of investment tax credits and enterprise allowances would be available to coops, but perhaps on terms preferential to those avaialbale for capitalist firms, especially where workers (and their representatives) risked their own savings.

Fourth, to dovetail with these mainly national-level initiatives, it is necessary to provide a framework which ensures that agencies at other levels concerned with the development of firms with majority ownership br workers continue to flourish and to grow stronger. Only by having vibrant local organizations can the potential dangers of bureacratisation in the proposed Institute be curbed and the advantages of flexibility via a multiplicity of local agencies be assured. Measures to maintain and to enhance local institutions include grants and loans from central and state government as well as private foundations, as has happened to some extent with ICA and PACE.

Fifth consideration might be given to introducing a system where, at least in the short term, the state and federal authorities might in some cases use their buying powere in the market-place to favour coops. Thus when considering bids for a public sector consruction project a coop bidder might be awarded the contract even though theirs was not the lowest bid. (Of course, the difference could not normally be substantial). The government might be especially predisposed to discriminate in favor of coops in this way in industries widely regarded as not being very competitive.

IV General Measures to Encourage Other Forms of Sharing

So far as firms with some, though less than a majority, degree of worker ownership are concerned, in the next five years a reasonable goal might be to aim for a situation in which individual workers own at least 10% of the voting stock in one-fifth of American corporations. (In 1984, Sing estimates that this threshhold had been attained in about 30 Fortune 500 companies.)

To this end, various enabling measures would be introduced that would facilitate extensions of workplace democracy and enhanced worker influence over their working environment, though to a more limited extent than do steps that provide for the expansion of the cooperative sector. This would be achieved by enabling legislation that fostered the spread of worker participation in ownership and in profits in conjunction with enhanced participation by workers in decision-making. Though in the short term these policies might well result in only modest improvements, nevertheless, I believe that such extensions of democracy are real and are likely to result in real economic benefits and greater social justice.

One of the reasons for coupling increased employee ownership with enhanced worker participation is that, despite the success of lower-level participation schemes (e.g. H.E.W., 1972), surveys of such participation schemes show that they can come up against the not inconsiderable problem that they are perceived by middle-managers as a threat to their prerogatives, or by the workforce as having little effective power. Consequently they are often terminated by the management. Or they can wither away through worker disinterest, especially if it is widely perceived (as has happenened with some employee stock ownership plans) that the plan is not being operated in the best interests of workers. Policies need to be developed which, on the one hand, enable workers to capitalise on the new opportunities presented by innovations such as the ESOP legislation to gain more influence over their workplace environment and, on the other hand, to persuade management that the new context is unlikely to be a zero-sum game.

For example, as worker ownership in particular companies assumes a significant level--say 5% of total equity--this might be used as leverage by workers (and their representatives). By using the power conveyed by ownership of significant blocks of equity the voices of workers would be heard more plainly than is presently the case. Organisation of this latent power in principle could lead to major influence by workers on strategic issues. As the decision-making ethos within the firm changed, so might the tastes of workers for growing involvement in enterprise decision making.

The implication of this line of reasoning is, of course, that policies need to be introduced which encourage these trends. Phenomena such as the growth of worker ownership might be encouraged by the expansion of share-option schemes. Thus the provisions of various ESOP

Acts that give companies tax concessions in return for issuing stock to workers might be amended so that the incentives for companies to behave this way were even stronger. This might take place in conjunction with a tax-based incomes policy--once workers had received the maximum permissible wage increase in any period companies might be encouraged to issue shares to workers as part of their remuneration, with the provision that such shares not be redeemed for (say) three years. But in all cases measures should be designed so as to encourage _broad_ worker ownership. Initiatives must guard against the tendency of much previous ESOP legislation to favor managers'interests. It is crucial to establish public policy in this area that is generally regarded as being _just._ Equally it is vital to establish a _systemstic and coordinated_ public policy. Existing employee owned firms have suffered both because at most one-quarter have received loans or loan guarantees from the federal government, and also the limited assistance that has been provivded has come only on an _ad hoc_ basis and from diverse agencies.

The establishment of the Institute for Worker Ownership and Workplace Democracy/division of theDept. of Employment (see earlier) would be an important corollary measure. It would provide resources and information on diverse matters, particularly legal issues. It would assist in the design and execution of diverse educational and training courses. To this institution would be assigned the watchdog function of ensuring that legislation was being implemented to serve all categories of workers fairly and to take account of the historical lessons of the U.S. experience with employee ownership, as reviewed earlier. It is envisaged that the body would link with existing organizations (e.g. National Center for Employee Ownership, Profit Sharing Foundation) as well as universities with relevant programs.

V Summary and Conclusions

In this brief paper I have outlined various measures that a government committed to extending democracy and social justice as well as to developing a more vigorous economy might wish to consider. The principal point of departure is that true democrary requires democratising the workplace. It is only when the workplace has been democratised that the possibility of a democratic society exists. I believe that the best available theoretical and empirical evidence can be used to provide support for all elements in the package. Also most aspects of the proposals have intellectual antecedents among progressive thinkers, and in some cases, historical precedents exist for particular ideas.

I believe that the economic consequences of such a programme could be quite substantial. On the supply side, there is every reason to believe that the measures would have genuine "supply-side" effects including a strong boost for productivity. And if introduced in tandem with a stimulatory fiscal programme and in conjunction with (or perhaps as an element in) a tax-based incomes policy, there should be a significant and non -inflationary stimulus to aggregate demand (and consequently jobs) especially through the generation of new investment spending. Finally the package has various implicatons for the role of trade unions. I believe that the net effect will be to expand the range of issues in which labor unions will be involved both within and between enterprises. At the same time, by reducing the significance of union involvement in the wage and effort bargain there will be a tendency to diminish the traditional adversarial role. In the present context of falling union membership I believe that these would be healthy developments which might help to stimulate interest in union membership amongst those who are not unionised.

Since some of the elements in the proposed policy package might be regarded as being fairly radical (though others represent more modest steps), the chances of such developments are probably nil during the term of the present Reagan administration and perhaps slim in a country without a strong labor movement. Yet in a different political context it is not an impossibility--few would have foretold the introduction of state laws on worker coops a decade ago.

Notes

1. For a review see Blumberg(1968)

2. For excellent reviews see Ireland and Law (1983) and Bonin and Putterman.

3. Cooperative experiences elsewhere have not been given much attention in the U.S. This is unfortunate because, as with the case of Mondragon, there is potentially much to be learned from study of these "exemplary models".' For reviews of experiences in many countries see the essays in Jones and Svejnar (eds.) (1982). For the case of Italian worker coops see Jones and Svejnar(1985), for the case of France Defourny, Estrin and Jones (1985) and for Poland, Jones (1985).

4. For the most part we will not review the theretical or empirical analysis, especially that of the critics, in any detail. This has appeared in several places including special sections of journals on the Share Economy-- J.C.E. (Dec. 1986), volume 3 of Advances in the Economic Analysis of Participatory and Economic Analysis (forthcoming, 1987), the inaugural volume of the N.B.E.R. Research Annual on Macro-- and several other manuscripts notably: Blanchflower and Oswald(1986), Cooper (1986), Estrin and Wilson(1986), Estrin, Grout and Wahhwani (1986), Meade(1986) and Wahhwani(1987). So far as the predicted effects on employment in a profit sharing economy are concerned some of the main inter-related objections to Weitzman's work are that: he assumes complete immobility of labor in the short run; there is no modeling of the wage setting process; considerations of fairness by workers and/or "efficiency wages" by employers may lead firms not to want to cut wages in the short run; any increase in employment is achieved at the expense of the pay of insiders. Most empirical work on these and other issues is still at an early stage and has been faced with the usual wide range

of difficulties that tend to confront pioneering empirical work.

5. For example, see the discussion in Bonin and Putterman (1986).

6. Jones and Schneider (1984) show how American self-help coops were effective in rehabilitating the unemployed during the Great Depression. For the case of contemporary worker coops in the U.K. see the evaluations by the Cooperative Research Unit at the Open University. Estimates put the cost of generating jobs at from 1500 to 4500 pounds per job--with even the top estimate substantially below the cost to social security of maintaining an average family whose head is unemployed.

7. But see Fitzroy and Krafts (1986).

8. Thus Jensen and Meckling stress the public-goods type problem that might be associated with group incentive schemes, as well as the potential for increased shirking by the central monitor under a profit-sharing regime.

9. See Estrin, Jones and Svejnar (1987) for a review of the arguments both pro and con.

10. For more on this issue see the essays in Jones and Svejnar (eds.) (1982).

11. But see Aldrich and Stern (1983), Conte and Jones (1985), Fanning and McCarthy (1986), Conte (1986) and Ben Ner(1987).

12. There have also been some non-domestic initiatives including a Presidential Task Force (October, 1986) which recommended that the U.S. encourage ESOPs in Central America and the Caribbean as a way of attaining economic justice.

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